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IN THE

**Supreme Court of the United States**

OCTOBER TERM, 1984

MARTIN FINE, WILLIAM BECKER and PHILIP  
BECKER, Individually and WILLIAM BECKER and  
PHILIP BECKER d/b/a BECKER & BECKER, all doing  
business as 649 BROADWAY EQUITIES CO.,

*Petitioners,*

vs.

BELLEFONTE UNDERWRITERS INSURANCE CO.,  
CITIBANK, N.A., and JOHANA ZUCKERMAN,

*Respondents.*

**PETITION FOR A WRIT OF CERTIORARI TO  
THE UNITED STATES COURT OF APPEALS  
FOR THE SECOND CIRCUIT**

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July 18, 1984

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## QUESTIONS PRESENTED

This diversity case involves the substantive insurance law of the State of New York and presents important questions under the *Erie R.R. Co. v. Tompkins* (304 U.S. 64 (1938)) line of decisions of this Court. While the District Court applied the applicable New York law as stated in the New York statutes and appellate court decisions, the Second Circuit Court of Appeals reversed the District Court, choosing not to apply the New York law but instead formulated a contrary federal rule and then applied it to this case.

As a result of the Second Circuit's cavalier approach, this case now presents novel questions of substantive insurance law for the State of New York which have general application to all fire insurance policies in force in that state, and as to which the decision of the Second Circuit directly conflicts with the decisions of the highest Court of the State. These questions relate to the application of Section 168 of the New York State Insurance Law, which voids fire insurance coverage if the insured is guilty of "false swearing" with respect to "any material fact or circumstance." This petition presents issues of substantial importance to all residential home and commercial building owners not only in New York State but also elsewhere throughout the United States. The questions presented are:

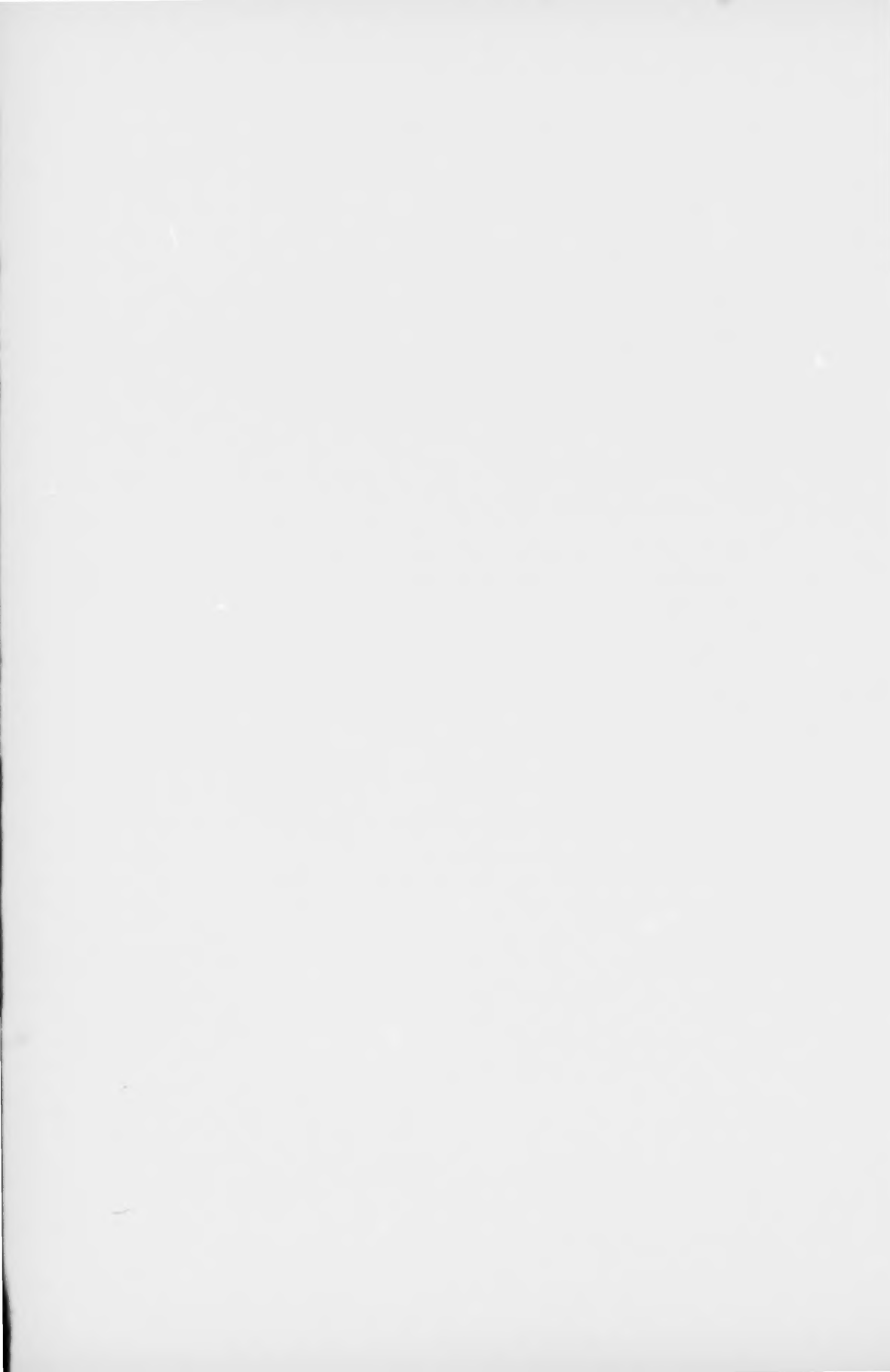
1. Whether a Court of Appeals in a diversity insurance law case is at liberty to totally disregard applicable state substantive law and instead formulate and apply its own federal common law in direct conflict with current decisions of the governing state's highest court?
2. Whether it is sufficient to void a fire insurance policy in New York State if testimony found to be inaccurate or false is not found to be "wilful" or "made with intent to deceive"?

3. Whether non-wilful inaccurate or false testimony during an insurance company's investigation is deemed "material" for purposes of voiding an insurance policy in New York State based solely on the insurance company's decision that it relates to a relevant and productive area of inquiry.



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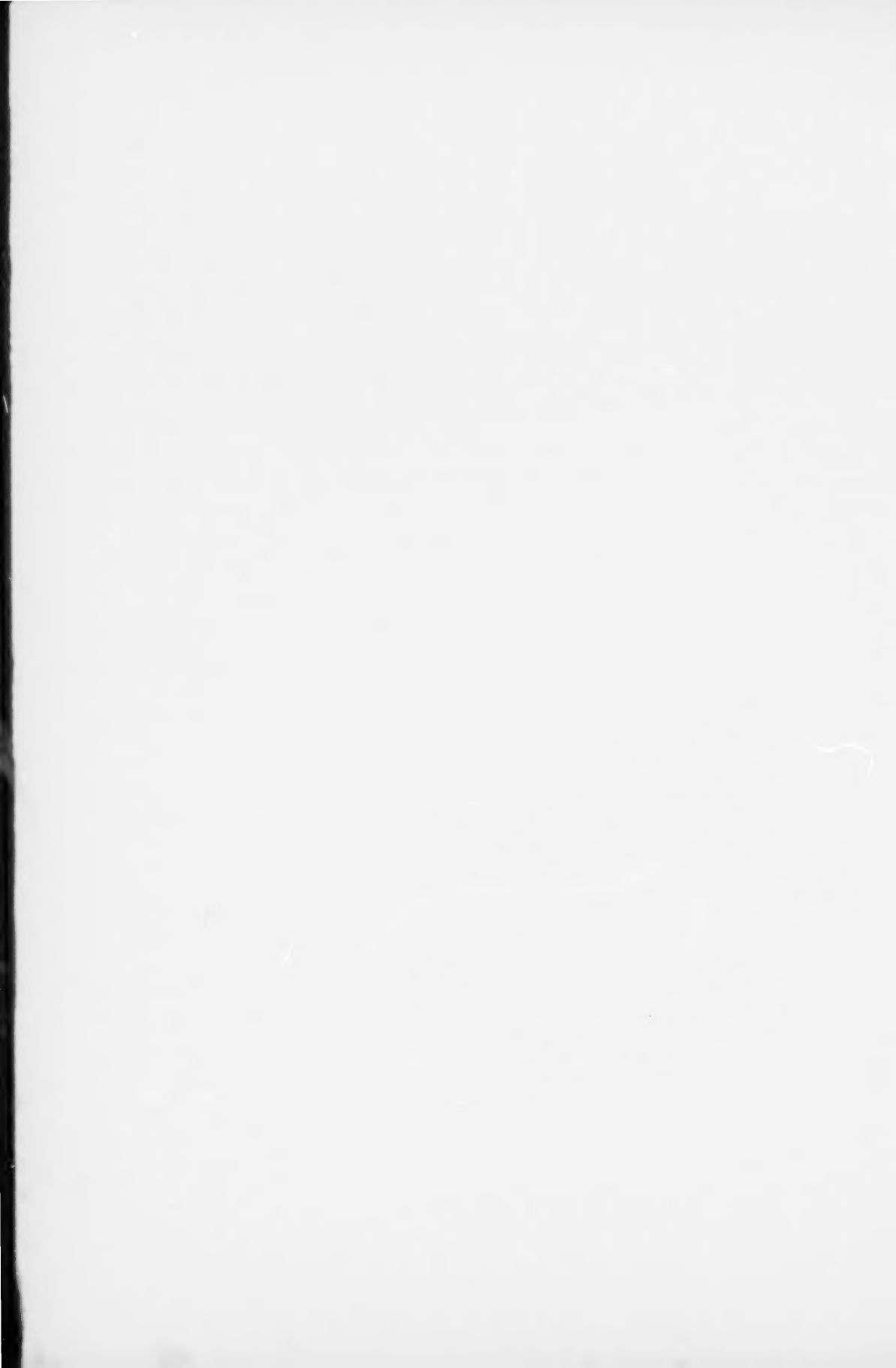


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IN THE**Supreme Court of the United States**October Term, 1984

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No.

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MARTIN FINE, WILLIAM BECKER and PHILIP BECKER,  
Individually and WILLIAM BECKER and PHILIP BECKER d/b/a  
BECKER & BECKER, all doing business as 649 BROADWAY  
EQUITIES CO.,

*Petitioners,*

vs.

BELLEFONTE UNDERWRITERS INSURANCE CO., CITIBANK,  
N.A., and JOHANA ZUCKERMAN,

*Respondents.*

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**PETITION FOR A WRIT OF CERTIORARI TO THE  
UNITED STATES COURT OF APPEALS FOR THE  
SECOND CIRCUIT**

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Petitioners MARTIN FINE, WILLIAM BECKER and PHILIP BECKER, individually and WILLIAM BECKER and PHILIP BECKER d/b/a BECKER & BECKER, all doing business as 649 BROADWAY EQUITIES, CO.,\* respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit dated December 29, 1982, and entered on January 3, 1983, reversing a judgment rendered in favor of petitioners in the

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\* These are all individuals and partnerships with no corporate parents or subsidiaries.

United States District Court for the Southern District of New York in the amount of \$1,534,687.60 plus interest.

### OPINIONS BELOW

The opinion of the Court of Appeals, dated January 3, 1984, is reported at 725 F.2d 179, and appears in the Appendix hereto, along with the opinion of the District Court for the Southern District of New York dated December 29, 1982, and the subsequent opinion of that court dated June 15, 1984, denying petitioners' motion for a new trial on the issue of wilfulness.

### JURISDICTION

The decision of the Court of Appeals for the Second Circuit was rendered on January 3, 1984. Petitioners' petition for rehearing was denied by the original panel on February 21, 1984 and a petition for rehearing *in banc* was denied on April 24, 1984. This petition for certiorari was filed within 90 days of that date. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

### STATUTORY PROVISION INVOLVED

Section 168 of the Insurance Law of the State of New York (McKinney 1966 & Supp. 1983), provides in pertinent part as follows:

§ 168. Fire insurance contract; standard policy provisions; permissible variations

1. The printed form of a policy of fire insurance, as set forth in subsection six, shall be known and designated as the "standard fire insurance policy of the State of New York."



2. No policy or contract of fire insurance shall be made, issued or delivered by an insurer or by any agent or representative thereof, on any property in this state, unless it shall conform as to all provisions, stipulations, agreements and conditions, with such form of policy.

\*\*\*\*\*

6. [now 5.] The form of the standard fire insurance policy of the State of New York (with permission to substitute for the word "company" a more accurate descriptive term for the type of insurer) shall be as follows: \*\*\*

Concealment, fraud.

Thus entire policy shall be void if, whether before or after a loss, the insured has wilfully concealed or misrepresented any material fact or circumstance concerning this insurance or the subject thereof, or the interest of the insured therein, or in case of any fraud or false swearing by the insured relating thereto.

### STATEMENT OF THE CASE

This is a diversity action (originally brought by petitioners in the state court, but removed by respondents) to recover the proceeds of an all risks insurance policy covering the virtual total loss by fire of three adjoining 19th century structures in New York City. The District Court, following a bench trial, awarded judgment to petitioners in the amount of \$1,534,687.60. (A-1,31)\* The Court of Appeals for the Second Circuit reversed and directed entry of judgment for respondents. (725 F.2d at 184; B-12) The sole ground for the reversal was the Court of Appeals determination that the insurance company was entitled to prevail on a defense of "false swearing" which voided the policy under New York statutory law.

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\* Numbers in parentheses refer to: Tr. (Trial Transcript), 2A- (Appendix in Court of Appeals); and A-, B-, C- (Appendix to this Petition).

## Background Facts

Petitioners are successful real estate investors and developers with extensive experience in Manhattan properties (Pltf's Ex. 5, Tr. 83, 2A-241).

In 1977, the partnership contracted to purchase three buildings, 649, 653 and 657 Broadway in New York City. The buildings were contiguous five and six-story buildings with a stylistically unified marble and cast iron facade. They were located on the west side of Broadway in an area of lower Manhattan known colloquially as "NO-HO" (north of Houston Street). They were uniformly two hundred feet deep and comprised approximately 158,000 square feet of space above grade level (plus basements and sub-basements), divided into approximately seventeen lofts. The three buildings were operated as a single unit and heated by a new boiler located in the basement of the middle building (No. 653) (Pltf's Ex. 36C, Tr. 91, 92). Title passed to plaintiffs in June, 1978. The buildings were occupied by tenants engaged in light manufacturing, warehousing, and in a few instances by artists in residence. (A-3).

The buildings originally were operated as the main store of the W & J Sloane Department Stores, and contained many beautiful architectural details, including high ceilings, large windows, arches, facades, and a Victorian interior with wood and plaster decorations. (A-3).

Prior to purchase, petitioners had retained an architect who had participated in many successful conversions of properties of this type, who advised petitioners on the feasibility of converting the buildings to cooperative, condominium or rental apartments. Plans were drawn and filings made with the appropriate government agencies. The conversion was permissible without the need of a zoning variance. Tax policy encouraged such a program by providing tax benefits as of right if a conversion to residential use was undertaken. (A-4). The projected net profit upon successful completion of the conversion program was \$4.5 million (A-15).

Petitioners proceeded to arrange for insurance to cover 31 properties owned by them, including the subject buildings. On November 7, 1978, a policy was issued by Respondent Bellefonte, with an inception date of October 11, 1978. The policy issued was an "All Risks" policy insuring 31 properties owned by plaintiffs for a total value of \$19,000,000. The properties in question are listed as locations 24, 25 and 26, with various amounts of insurance totalling \$1,700,000 (less than 10 percent of the total policy coverage) on the three buildings, plus coverage in the aggregate amount of \$150,000 for loss of rents, plus coverage for debris removal. The policy separately provided a \$2,000,000 limit of liability for any one loss (Pltf's Ex. 5). The amount of insurance carried for the subject buildings is the same amount as the prior owner carried. The insurance company never undertook any inspection of the buildings, notwithstanding its absolute right to do so. (Tr. 1175-1177).

The buildings were equipped with a wet pipe sprinkler system. Petitioners continued existing contracts with Honeywell Protective Systems, Inc. and AFSA Protective Systems, Inc., two companies which monitored the sprinkler system alarms and various devices attached thereto. One of the devices was the water flow alarm, which was operated by a flow of water through the sprinkler system, which transmitted an alarm to a central station, which in turn transmitted an alarm to the Fire Department. Another device was a temperature monitor designed to transmit an alarm if the water temperature in the sprinkler roof tank (on number 657 Broadway) fell below freezing. (A-7, 8).

On February 14, 1979, a fire of major severity occurred. A water flow alarm was received by the Central Alarm Station shortly before midnight and the Fire Department was dispatched. The fire advanced quickly and various high level Fire Department personnel concluded the fire to have been incendiary in origin (A-12-13).

The fire originated within the locked premises of the third-floor tenant (Lion Leather) of the 653 building. The owner had no access to these premises. (Tr. 2693, 2A-167a). Lion Leather's

lease was expiring in two weeks (Tr. 2553); and they had not yet found a new location. The tenant collected \$500,000 from their insurance carrier for the loss to the contents of their premises (Tr. 2581).

This tenant had access to the sprinkler control valves on the third floor and the main valves in the basement (Tr. 2508).

The fire resulted in the total destruction of two of the buildings (649 and 653 Broadway); the third building (657 Broadway) was damaged in the stipulated amount of \$214,221.

### **The Sprinkler System**

Apart from the cause of the fire—apparently tenant arson—the most significant factual question at the trial related to the functioning of the sprinkler system which affected the spread of the flames. Witnesses testified that the sprinklers were not observed to operate in two of the three buildings, and expressed the opinion that this failure contributed to the extent of the fire loss. At the trial, the insurance company tried to establish—without success—that the sprinkler system had not been properly maintained by the owners and that improper heating practices had caused the system to freeze up (A-13-14, 21-22).

The company also argued that inaccurate or “false” testimony (found by the District Court) concerning thermostat settings for the furnace and instructions concerning the inspection and maintenance of the system constituted “false swearing” within the meaning of the Section 168 standard statutory fraud and concealment clause in the policy, thereby voiding it. This latter question is the issue presented on this appeal. It was decided adversely to respondents in the District Court; and adversely to petitioners in the Court of Appeals.

The key facts as found by the District Court are summarized below:

1. The sprinkler system was in operation on February 11 (three days before the major fire) at the time a minor fire occurred in a discotheque located in the basement of one of the subject buildings (A-10,22).

2. The building superintendent testified that the sprinkler system was operative during the day of February 14, the day of the major fire, and that it had developed a small leak on the fifth floor of one of the buildings in the morning of that day (A-10-11, 22).
3. The lack of any alarm signal indicated that the temperature of the water in the roof tanks serving the sprinkler system was not below freezing (A-8, 21).
4. The fire was discovered only after a sprinkler-activated water flow alarm in the basement of one of the buildings sounded at the alarm company's central headquarters, produced by a flow of water in the sprinkler lines (A-8, 11).
5. A single furnace (in No. 653) heated all three buildings. Because of the need for plumbing repairs, no heat was supplied to one of the buildings (No. 657) for 56 hours prior to the fire, while heat continued to be supplied to the other two buildings. Fire Department personnel concluded that the standpipe for the sprinkler system in the *non-heated building* was not frozen at the time of the fire (A-11, 12).
6. There were several factual theories as to why the sprinkler system failed to control the fire in the two heated buildings:

- deliberate shut-off of the system by an arsonist
- a frozen roof tank
- partial freezing of the sprinkler lines
- a basement blockage.

The District Court found that the "most persuasive" theory was that the system was partially frozen and therefore blocked by ice. (A-13).

7. The cause of this partial freezing of the sprinkler system was never established to the District Court's satisfaction. The Court concluded: "Perhaps that re-

sult was produced by a boiler malfunction, an arsonist's act, a plumber's mistake, together with the extreme temperature." (A-21).

### The Insurance Company's Defense

The insurance company argued that the partial freezing of the sprinkler system had been caused by a lowering of thermostat settings in the heating system, allegedly ordered by the new owners. The District Court found that the owners had in fact directed the building superintendent to reduce the nighttime settings for the heat timer, so that it would not turn the furnace on until the outside temperature reached was below 25° (the superintendent testified he actually set the switch at 30°). But the Court also found that a 25° setting was not shown to be contrary to acceptable industry standards for commercial buildings of this type, or that a reasonable person would anticipate that such a setting would cause the water in the sprinkler system to freeze. (A-9).

More significant were the Court's findings that the standpipe system *in the building in which the heating system had been turned off* was actually functioning at the time of the fire, and that *the roof water tank on that building was also operative*, indicating that something more than the furnace operation alone was involved. (A-21).

Most importantly, weather bureau records showed that the outside temperature in New York City never rose above 30° for ten days prior to the fire (or above 25° for the entire six day period preceding the fire). At a setting of 30°, as found by the trial court, the furnace was *in full operation* (except for brief electrical maintenance shutdowns which were immediately repaired) *throughout the entire period*. (A-10, 17)

In summary, at the time of the fire, the trial judge found:

- A. The sprinkler system was functioning in 657 Broadway.
- B. The sprinkler system in 649 and 653 Broadway had been functional earlier on the day of the fire.



- C. There was sufficient function in the system at the time of the fire to cause water discharge and activate the water flow alarm to summon the Fire Department.
- D. The cause of the non-functioning of the sprinkler system when the Fire Department arrived was most probably partial freezing of the pipes.
- E. Any partial freezing of the pipes was contributed to by an extended period of extremely cold weather.
- F. Any partial freezing was not the result of any deficiency in sprinkler maintenance.
- G. Any partial freezing was not the result of the change in the heat timer setting.
- H. Any partial freezing of the sprinkler system would have occurred whether the heat timer was set at 40°, 30° or 25°.
- I. Therefore the new owners' change in heating policy was *not* the cause of any partial freezing and malfunction of the sprinklers.

The District Judge explicitly found that the owners had not violated the preventive maintenance or increased hazard provisions of the policy. (A-16)

### **The False Swearing Defense**

During the insurance company's investigation of the fire loss, its counsel interrogated two representatives of the owner on many different aspects of the incident. The lengthy questioning included questions about the daytime and nighttime outside temperature settings which activated the operation of the furnace. Both said that the daytime setting was at 55° and the nighttime setting was at 40°. They also testified that the building superintendent continued to have responsibility for sprinkler maintenance.

The District Court found these statements to be "inaccurate and consequently false" (also describing them as "mistaken") and

credited instead the trial testimony given by the building superintendent that he had been instructed by the new owners to set the heat timer at nighttime at an outside temperature of 25° (but had actually set it at 30°), and also had not been given any instructions with respect to sprinkler maintenance (although the trial judge noted that the superintendent's testimony was "confused") (A-14, 16).

However, the District Court expressly found that this inaccurate or false testimony was not material since it made no difference as far as the loss was concerned:

Here the statements were not material to the investigation. Given the extreme temperatures during the period from February 5th to February 14 as noted above, whether the heat timer setting was 25 degrees, 30 degrees or 40 degrees would not have affected the operation of the heating system. Further there was no testimony that a 25 degree or 30 degree setting would have constituted a practice which would have reasonably been foreseen to result in a freezing condition, which, in turn would have made the sprinkler system inoperative.

Similarly with respect to the sprinkler maintenance issue, whether Aloisio was instructed to perform maintenance on the sprinkler system or not, in fact he did take the action necessary to repair the system, and there is no indication in this record that any failure of record keeping or regular maintenance was in any way responsible for the freeze-up. Since the Fine policy of freeze-out has not been proved to be the cause of the freeze-up, the false statements, viewing them as such, were not material as contemplated under section 168. (A-17)

The Court of Appeals, formulating its own federal common law rule contradicting the New York Court's, reversed on this issue, holding that the test of materiality was not whether the *ultimate* fact was material, but rather whether it seemed rele-



vant or productive to the insurance company *at the time of the interrogation*.

It thus appears that materiality of false statements is not determined by whether or not false answers deal with a subject later determined to be unimportant because the fire and loss were caused by factors other than those with which the statements dealt. False sworn answers are material if they might have affected the attitude and action of the insurer. They are equally material if they may be said to have been calculated either to discourage, mislead or deflect the company's investigation in any area that might seem to the company, at that time, a relevant or productive area to investigate. (725 F.2d at 184; B-12).

## REASONS FOR GRANTING THE WRIT

### 1. THE COURT OF APPEALS TOTALLY DISREGARDED THE APPLICABLE NEW YORK LAW AND INSTEAD FORMULATED ITS OWN CONTRARY FEDERAL RULE

In reversing the District Court on the law, the Court of Appeals brushed aside well-established New York law and instead adopted and applied its own principle of federal common law.\* The Court of Appeals held that: "In our view, the trial judge's definition of materiality was far too restrictive and *not in accordance with long-established case law*." (725 F.2d at 183; B-9) (Emphasis added). The "long-established case law" the Court of Appeals based its decision on consisted of the following: (1) a 1884 decision by this Court, *Clafin v. Commonwealth Insurance Co.*, 110 U.S. 81 (1884) (a diversity case decided under *Minnesota* law); (2) a 1982 Tenth Circuit decision, *Long v.*

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\* While the Second Circuit's decision is limited to fire insurance policies, property damage insurance policies usually also contain a similar false swearing provision. 44 Am. Jur. 2d, *Insurance* §1371 (1982); 31 N.Y. Jur., *Insurance* § 1298 (1963). Accordingly, the Second Circuit's decision, if it is followed by other courts, will have a substantial impact throughout the insurance field.

*Insurance Co. of North America*, 670 F.2d 930 (10th Cir. 1982) (decided under *Oklahoma* law); (3) a 1957 Fifth Circuit decision, *Chaachou v. American Central Ins. Co.*, 241 F.2d 889 (5th Cir. 1957) (decided under *Florida* law); and two authorities cited in the *Chaachou* decision: (4) a 1906 Wisconsin Supreme Court decision, *Meyer v. Home Ins. Co.* (decided under *Wisconsin* law), and (5) a 1952 general treatise on insurance law, 3 W. Freedman, *Richards on Insurance*, § 510 (5th ed. 1952), in which the sole authority for the principle of law the Court of Appeals quotes in its opinion is a 1902 Wisconsin Supreme Court decision, *Bannon v. Insurance Co. of North America*, 115 Wis. 290, 91 N.W. 666 (1902) (decided under *Wisconsin* law).

This is a diversity case. The law of New York is the law that must be applied to the factual issues in this case. The District Court properly and appropriately applied New York law. The Court of Appeals also was absolutely bound to apply New York law. It did not. The Court of Appeals disregarded New York law. Instead, the Court of Appeals then applied its own contradictory federal law to the case, and reversed the decision of the District Court which had correctly relied upon New York law.

The Court of Appeals has thereby flaunted the *Erie R.R. Co. v. Tompkins*, 304 U.S. 64 (1938) line of decisions of this Court, including *West v. American Tel. & Tel. Co.*, 311 U.S. 223 (1940); *Guaranty Trust Co. v. York*, 326 U.S. 99 (1945); *Byrd v. Blue Ridge Rural Elec. Coop., Inc.*, 356 U.S. 525 (1958); and *Hanna v. Plumer*, 380 U.S. 460 (1965). Under the *Erie* line of decisions, the Court of Appeals had no choice but to apply the applicable New York statute (Section 168 of the New York Insurance Law) as interpreted by New York's highest state court (the New York Court of Appeals) and the New York intermediate appellate state courts (the First, Second, Third and Fourth Department of the Appellate Division). See 19 C. Wright, A. Miller & E. Cooper, *Federal Practice and Procedure* §§ 4503-4507, 4514 (1982); C. Wright, *The Law of Federal Courts* §§ 55-60 (4th ed. 1983).

The decision of the Second Circuit holds that *any* incorrect answer by the insured during the course of insurance company interrogation is grounds for voiding a fire insurance policy.\*

Under this decision, there is no distinction between testimony of the insured that is *wilfully false*, on the one hand, and testimony of the insured that is *simply mistaken, incorrect, inaccurate, negligent or inadvertent*.

Nor does it matter whether the specific subject of the interrogation relates to a contributing cause of the loss.

The Court of Appeals established an *irrebuttable* presumption that if the insurance company asks the question, the answer is "material," and if that answer is incorrect, then the coverage is automatically cancelled, after the fact.

This is a repudiation of the law of New York State in three significant respects:

(a) *The Court of Appeals has disregarded the New York law which dictates that "false swearing" requires "wilfulness" and an "intent to deceive the insurer."*

The principal case relied on by the Court of Appeals was the 1884 decision by this Court in *Claffin v. Commonwealth Ins. Co.*, 110 U.S. 81 (1884). Apart from the fact that the *Claffin* decision involved Minnesota law, the Court of Appeals adopted the language of that opinion as to the materiality, while completely disregarding its standard of falsity:

A false answer as to any matter of fact material to the inquiry, *knowingly and willfully made, with intent to deceive the insurer*, would be fraudulent. (725 F.2d at 183; B-10) (Emphasis added).

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\* An insurance company interrogation is a unique procedure, far more wide-ranging and unrestricted than even a pre-trial deposition. The insured generally does not have the freedom of asserting privilege or any other grounds for declining to answer. Any refusal to answer is at the peril of forfeiture of all coverage under the insurance contract. See *Bulzomi v. New York Central Mutual Fire Ins. Co.*, 92 A.D. 2d 878, 459 N.Y.S. 2d 861 (2d Dep't 1983).

The Second Circuit simply brushed the wilfulness requirement aside. If the Court of Appeals had properly applied the law as established by this Court's decision in *Claffin*, it would have affirmed the decision of the District Court.

The Court placed reliance upon a 1906 Wisconsin Supreme Court decision, referred to in a Fifth Circuit decision which was decided under Florida law, *Chaachou v. American Central Ins. Co.*, 241 F.2d 889 (5th Cir. 1957). The Wisconsin Supreme Court decision, *Meyer v. Home Ins. Co.*, 127 Wis. 293, 299-300, 106 N.W. 1087, 1089 (1906), (which was based on Wisconsin law) likewise stated that:

If the plaintiffs *knowingly and wilfully, with intent to defraud the defendants*, swore falsely in making the proofs of loss, such act amounted to a fraud upon the defendants which avoided the policies, irrespective of the ultimate effect upon the defendants. (725 F.2d at 184; B-11) (Emphasis added).

At no time did the District Court here make a finding of fact or otherwise conclude that the owners' testimony was "knowingly" or "wilfully" false or "with intent to deceive the insurance company." (A close reading of the nature of the questioning and answers will show why—it was far too casual to be deliberate.)

Believing that the Court of Appeals might have misunderstood the District Court's characterization of the testimony as "inaccurate and consequently false" to mean "wilfully false," petitioners moved for a new trial before the District Court to correct this impression on the ground that it was a "manifest mistake of fact." The District Court concluded that no such mistake had been made—its decision was a naked finding that the testimony was "false":

Plaintiffs have alleged that if the court had found the false swearing to have been "knowingly and wilfully made, with intent to deceive the insurer," such finding would have constituted a "manifest mistake of fact." *There was no such finding, only a finding that the testimony given was false.*

While it might be argued that a further hearing is required to determine the insurer's subjective reaction to the false testimony, even the plaintiffs wisely have not urged that such an empty exercise be undertaken. Obviously by merely posing the questions, falsely answered, the insurer determined the "area [to be one] that might seem to the company, at that time, a relevant or productive area to investigate." *Fine*, slip op. at 7486.

As this court understands the Court of Appeals' decision, any false swearing in an examination by an insurer in a "relevant or productive area" voids the policy. No further facts need to adduced to meet this standard. (C-2-3) (Emphasis added).

The difference between incorrect or "false" testimony and "wilfully false" testimony lies at the heart of the judicial fact-finding process. All human and judicial experience recognizes that there is rarely a witness who does not testify to something that is incorrect or *technically* "false." This every-day phenomenon has been recognized by courts for centuries. Indeed, if there was not a conflict in testimony, there usually would be no need for a trial.

Here is its judicial recognition in the Eighteenth Century (taken from 3A J. Wigmore, *Evidence*, § 1013 (J. Chadbourn rev. 1970)):

You will permit me to observe that there is a great difference between not recollecting circumstances, and a witness swearing to those that are false. The not recollecting may consist with integrity; the swearing to a falsehood never can. *Annesley v. Angelsea*, 17 How. St. Tr. 1139, 1421 (1743).

And here it is in the Nineteenth Century:

But the disbelief of what any witness has testified to does not necessarily impute to him falsehood and perjury. This would compel the jury in every case of contradictory testimony to disbelieve that one or the

other witness, or perhaps one set of witnesses or the other, must be willfully perjured. Nothing is further from the truth than such a conclusion. A thousand innocent mistakes are committed in courts of justice, for one intentional and corrupt falsehood; and it is the commonest duty of a jury to distinguish between conflicting testimony arising from the mistakes of witnesses. *Kinney v. Hosea*, 3 Harr. 397, 401 (Del. 1841). (*Id.*)

(b) *The Court disregarded the "clear and convincing" proof requirement.*

It is, of course, well established that a finding of fact of "wilfulness" requires an express factual finding and such a finding must be sustained by "clear and convincing evidence"—not by a mere preponderance of evidence. See e.g., *Barr Rubber Products Co. v. Sun Rubber Co.*, 425 F.2d 1114, 1120-21 (2d Cir.), *cert denied*, 400 U.S. 878 (1970).

In *Barr Rubber Products Co.*, 425 F.2d at 1120-21, the Court indicated that:

At the outset we are troubled by the lower court's failure to define the quantum of proof required to substantiate a charge of perjury in a civil, non-criminal case of this kind. Generally, a civil plaintiff must prove his affirmative case by no more than a preponderance of the evidence. Ordinarily this is true even where a criminal act is charged as part of a civil case. [Citing cases.] We assume from the lower court's silence that it applied this normal preponderance of the evidence test.

However, there is amply authority of long standing that to substantiate charges of fraud or of undue influence, at least in actions seeking the recovery of monies paid or the rescission or cancellation of contracts, a litigant must present clear and convincing proof.

The "clear and convincing" standard of proof is a substantive requirement of New York law. See, e.g., *C.E.H. McDonnell v.*



*American Leduc Petroleum, Ltd.*, 456 F.2d 1170, 1176 (2d Cir. 1972); *Hutt v. Lumbermens Mutual Cas. Co.*, 95 A.D. 2d 255, 466 N.Y.S. 2d 28, 29-30 (2d Dep't 1983). The Court in *C.E.H. McDonnell*, 456 F.2d at 1176, held that:

Appellants argue that the opinion below simply does not spell out the necessary findings to hold them liable in fraud and deceit and they emphasize the high quantum of proof required. The trial court opinion does not make clear the standard of proof it used. This failing is especially troublesome because, under both California and New York Law, fraud must be proved by clear and convincing evidence.

(c) *The Court of Appeals has effectively made the insurance company the sole judge of "materiality."*

The new rule of law on "materiality" enunciated by the Court of Appeals is one of subjectivity:

False answers are material if they might have affected "the attitude and action of the insurer." (725 F.2d at 184: B-12).

They are also material "if they may be said to have been calculated either to discourage, mislead or deflect" the insurer's "investigation in any area that might seem to the company, at that time, a relevant or productive area to investigate." (*Id.*)

By simple definition, *any* questions asked by insurance company counsel during the investigation of a loss seems "relevant or productive" or the question would not be asked. This creates a *per se* rule of materiality, at direct odds with the case law of New York State.

## 2. THE POTENTIAL IMPACT OF THE SECOND CIRCUIT'S NEW FEDERAL COMMON LAW RULE IS UNLIMITED

The opinion of the Second Circuit portends disastrous consequences for the future of fire insurance coverage in New York State. It dramatically alters the substantive law developed by

the New York courts over many years in interpreting and applying New York statutory law. As discussed below, the Court's decision is *directly contrary* to two recent decisions of the New York Court of Appeals. Unless modified, it will create significant confusion and mischief in future cases and, if followed by other courts, it will result in unusually severe and harsh results to many insured property owners.

It has long been recognized that the states have both the interest and capacity to regulate the insurance industry because of its broad public impact on their citizens :

The business of insurance has been widely regulated by statute. Because of the far-reaching effect of the insurance business upon the individual policyholders and the economy in general, it is a business which is affected with a public interest. It is accordingly within the police power of the states to subject the business to reasonable regulation. A state has the right to regard the business of insurance as one dependent upon the exercise of a franchise which is subject to regulation by it.

(2A G. Couch, *Insurance Law*, §21:1, at 218 (M. Rhodes, 2d ed., rev. vol. 1984)).

The federal courts should exercise particular self-restraint in not usurping this function.

The New York state insurance law requires fire insurance policies to be voidable in the case of *fraud or false swearing* on the part of the insured. *New York Insurance Law*, Section 168 (McKinney 1966 & Supp. 1983). By applying that statute to the facts in this case the Second Circuit has: (a) extended the statute to include *inaccuracy* as the ground for voiding coverage; and (b) established a rule of law which permits the *insurance company* to determine what is and is not material.

The impact of the Second Circuit decision, if allowed to stand, is to place all New York property owners in jeopardy of after-the-fact avoidance of coverage because of inadvertent misstatements during the course of the insurance carrier's post-loss occurrence investigation. This case provides an irresistible in-



centive for insurance carriers to refuse payment routinely and then conduct far-ranging examinations looking for the inevitable faulty recollection or the inadvertent incorrect statements on which to escape liability. Innocent misstatements, differing perceptions, failures of communication all become potential booby traps to invalidate coverage after the loss has occurred.

### 3. THE RULE OF STATE LAW PROMULGATED BY THE SECOND CIRCUIT IS CONTRARY TO A LONG LINE OF DECISIONS OF NEW YORK STATE'S HIGHEST COURT

#### (a) The Wilfulness Requirement.

In March 1983, the New York Court of Appeals squarely addressed the need for an explicit finding of "intent to defraud" to trigger the voiding of coverage under Section 168 of the New York Insurance Law, in *Jonari Management Corp. v. St. Paul Fire & Marine Ins. Co.*, 58 N.Y. 2d 408, 461 N.Y.S. 2d 760, 448 N.E. 2d 427 (1983).

The New York Court of Appeals in *Jonari Management Corp.* indicated that there might be circumstances where intent to defraud was not necessary if a misrepresentation was relied on by the insurance company *in issuance of a policy*, as contrasted to a proof of loss after a policy is issued:

St. Paul makes a novel argument that no fraud or intent to defraud was necessary in this case to work an invalidation of the policy under the 'Concealment, fraud' provision of the insurance agreement and that proof of misrepresentation alone was sufficient. Thus, it assigns as error, to which objection was taken, the inclusion by the trial court in the questions submitted to the jury of the words 'fraudulently' and 'with an intent to defraud'. No relevant authority is cited for the proposition urged. Conceivably, misrepresentation by an insured, unattended by an intent to defraud, might be given significant effect in determining

the validity of a policy of insurance if the misrepresentation preceded the issuance of the policy. In that instance a misstatement of a relevant fact, intentional though of innocent purpose as regards the insurer, might lead the insurer to accept a risk it would not have undertaken with full knowledge of the true facts, and the resolution of the rights of the parties in the event of a loss might be determined by the materiality of the misrepresentation (*Sebring v. Fidelity-Phenix Fire Ins. Co. of N.Y.*, 255 N.Y. 382, see 9 Couch Cyclopedia of Insurance Law [2d ed.], § 38:27). (461 N.Y.S. 2d at 764).

But when a proof of loss is involved—as here—any falsehood or misrepresentation would require “intent to defraud” before it would void the policy under Section 168.

The New York Court of Appeals held in *Jonari Management Corp.* that:

When misrepresentation goes to proof of loss however, the cases uniformly speak of fraud, fraudulent, and intent to defraud when considering claims of invalidity under the ‘Concealment, fraud’ provision mandated by the Insurance Law § 168 (e.g., *Saks & Co. v. Continental Ins. Co.*, 23 N.Y.2d 161, 295 N.Y.S. 2d 668, 242 N.E. 2d 833; *Happy Hank Auction Co. v. American Eagle Fire Ins. Co.*, 1 NY2d 534 N.Y.S. 2d 870, 136 N.E. 2d 842; *Sunbright Fashions v. Greater N.Y. Mut. Ins. Co.*, 34 A.D.2d 235, 310 N.Y.S. 2d 760, *affd.* 28 NY 2d 563, 319 N.Y.S. 2d 609, 268 N.E. 2d 323 *supra*). Indeed, intent to deceive appears to be equated with intent to defraud in the case of claims asserted against an insurer: “[O]ne of the elements involved in the determination of whether an insured has forfeited his rights under an insurance policy because of fraud or false swearing as to his proof of loss is the intent of the insured; that is, whether the false statement with respect to a material matter was made wilfully and with the intention of

thereby deceiving the insurer' (13A Couch, Cyclopaedia of Insurance Law [2d rev ed] § 49A:66). Were intent to defraud not a necessary element, the discussion in *Sunbright* of the conclusive evidence of such intent would have been irrelevant, the making of false statements and production of spurious documents having been admitted. (461 N.Y.S. 2d at 764).

On July 2, 1984, the New York Court of Appeals reaffirmed this basic principle of New York law in *Deitsch Textiles, Inc. v. New York Property Ins. Underwriting Ass'n*, No. 450, slip op. at 3 (New York Court of Appeals, July 2, 1984). In *Deitsch Textiles, Inc.* the New York Court of Appeals stated the New York law as follows:

Specifically, "[i]f it appears that a plaintiff has *wilfully and fraudulently* placed in the proofs of loss a statement of property lost which he did not possess, or has placed a *false and fraudulent* value upon the articles which he did own, he is not entitled to recover anything.' " (*Id.* at 2-3) (emphasis added).

The New York Court of Appeals held in *Deitsch Textiles, Inc.* that:

Turning first to *Deitsch*, we find that the record is devoid of proof of this defense. At trial, the insurance companies primarily attempted to discredit, as speculative, two inventories taken by plaintiff of the goods damaged after the fire. However, they tendered no proof of intent to defraud—a necessary element to the defense. (See *Jonari Mgt. v. St. Paul Fire*, 58 NY2d 408, 417; *Sunbright Fashions, Inc. v. Greater New York Mut. Ins. Co.*, 34 AD2d 235, *affd* without op 28 NY2d 563.) They also contended that *Deitsch* never offered invoices substantiating loss of certain equipment into evidence at trial. While this alleged failure may be relevant to whether *Deitsch* offered sufficient proof of damages, it fails to amount to fraudulent conduct such as would vitiate the policies at issue. (*Id.* at 3).

In this case, the record is equally devoid of any proof of intent to defraud the carrier.

The effect of this recent reaffirmance of the New York rule by New York's highest court is to create a situation where the choice of forum produces diametrically different results. Out-of-state insurance companies can (as here) remove loss claims to the federal courts in the Second Circuit and defeat recovery by property owners which would be upheld if there were no diversity between the parties and the case was determined in the New York State courts.

The Second Circuit in this case has arbitrarily refused to apply the applicable New York law—the Court has eliminated the New York requirement of an “intent to defraud” the insurance company in order to void the policy coverage. This Court should exercise its certiorari jurisdiction to correct this plain and far reaching error of law.

The decision of the Second Circuit is out of keeping not only with the decisions of the New York Court of Appeals and the other New York appellate courts, but is also out of line with the applicable appellate court decisions of other states. In almost every instance in which a state court has decided to apply the forfeiture provision of its state insurance law on a finding of false swearing by the insured, the court has specifically found that the insured was engaged in a fraudulent scheme to obtain money that he was not entitled to, or to obtain some other substantial advantage, principally by overstating the value or nature of the property insured. See, generally, cases collected in 13A G. Couch, *Insurance Law* §§49A:60-74 (R. Anderson, 2d ed. 1982); 5A J. Appleman, *Insurance Law and Practice* §§3587-95 (Rev. Vol. 1970). None of those factors were present here.

#### **(b) The Materiality Requirement.**

The New York Cases have uniformly left the determination of “materiality” to the finder of the fact, rather than treating it as a matter of law.

The New York rule is that the materiality of a representation is an issue for the jury. *Porter v. Traders Ins. Co. of Chicago*,

164 N.Y. 504, 58 N.E. 641 (1900); *Sebring v. Fidelity-Phenix Fire Ins. Co.*, 255 N.Y. 382, 174 N.E. 761 (1931); *Happy Hank Auction Co. v. American Eagle Fire Ins. Co.*, 1 N.Y. 2d 534, 154 N.Y.S. 2d 870 (1956).

In the *Porter* case, the New York Court of Appeals was faced with the question of the materiality of the purchase price of a vessel which was the subject of the loss. The Court was asked to find as a matter of law that this purchase price was material to the defendant's inquiry. The Court declined to do so in the following manner:

I do not think it can be held as matter of law that the price paid for the steamer in question, under the circumstances, and before the extensive repairs were made, was a material fact bearing on the actual cash value at the time of the fire. The most that can be said about such a contention is that such an inquiry may be material according to the facts and circumstances of the case. (*Gray v. Central R.R. Co. of N.J.*, 157 N.Y. 483). It follows that the question whether the inquiry made at the examination, and which the insured declined to answer, was material or otherwise, was not a pure question of law, but one of fact, since its importance must always vary with circumstances, and being a question of fact, or a mixed question of law and fact, the finding of the trial court in favor of the plaintiff cannot be disturbed in this court. (164 N.Y. at 508).

In *Happy Hank Auction Co. v. American Eagle Fire Ins. Co.*, *supra*, 154 N.Y.S. 2d 870, the New York Court of Appeals reaffirmed its earlier holding in *Porter*. In *Happy Hank Auction Co.* the New York Court of Appeals reversed a finding by the Appellate Division (286 App. Div. 505, 145 N.Y.S. 2d 206) that tax returns and other documents of the insured were material to the insurer's inquiry and, therefore, the insurer was entitled to summary judgment as a matter of law. In support of its holding on materiality, the Appellate Division referred to the decision in *Claffin v. Commonwealth Ins. Co.*, 110 U.S. 81 (1884), relied

upon by the Second Circuit here, and concluded (as here) that the fact that the insurer's attorneys had questioned the insured with respect to the documents made them material. (145 N.Y.S. 2d at 210-11).

The New York Court of Appeals, however, squarely reversed the Appellate Division, holding that the question of materiality with respect to the tax return and the other documents was a question of fact for the jury. The Court refused to adopt as material any questions asked by the insurance company during the examination under oath. (154 N.Y.S. 2d at 872-73).

### CONCLUSION

The Second Circuit has repudiated the *Erie R.R. Co. v. Tompkins* line of decisions of this Court by writing its own contrary federal common law rule in a case where the law of the state plainly governs. Its decision not only creates grave hazards for insured property owners throughout New York State, but it also discards years of patient development of the law in the State courts. For these reasons, a writ of certiorari should issue to review and correct the decision of the Second Circuit.

Respectfully submitted,

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July 18, 1984

## APPENDIX



APPENDIX A

UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF NEW YORK

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MARTIN FINE, WILLIAM BECKER and PHILIP BECKER,  
individually and WILLIAM BECKER and PHILIP BECKER d/b/a  
BECKER & BECKER all doing business as 649 BROADWAY  
EQUITIES Co.,  
*Plaintiffs,*

-against-

BELLEFONTE UNDERWRITERS INSURANCE CO., CITIBANK,  
N.A. and JOHANA ZUCKERMAN,  
*Defendants.*

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U.S. District Court filed Jan 3 1983 S.D. of N.Y.  
80 Civ. 3747 (RWS) OPINION 54107

APPEARANCES:

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SWEET, D.J.

This is an intricate matrix of factual and legal issues involving insurance proceeds and arising out of a fire which totally de-



stroyed two buildings—649 and 653 Broadway in the early morning of February 14, 1979. Diversity jurisdiction is present. Plaintiffs, New York owners, Martin Fine, William Becker and Philip Becker, individually, and William Becker and Philip Becker, d/b/a Becker & Becker, all doing business as 649 Broadway Equities Co., (collectively "Fine"), brought this action against the defendant Bellefonte Underwriters Insurance Co. ("Bellefonte"), a Delaware corporation with underwriting offices in Texas. Based on the following opinion setting forth the facts and conclusions of law, judgment will be entered on behalf of Fine.

### **Prior Proceedings**

Fine initiated this action in the Supreme Court of the State of New York, New York County, on June 23, 1980, seeking recovery on a policy of insurance issued by Bellefonte for damages caused by the February 14, 1979 fire at the premises known as 649-51 Broadway, 653-55 Broadway, and 657-59 Broadway, ("649, 653, 657"). The action was removed to this court. Fine alleged eight causes of action against Bellefonte seeking recovery for damages under the fire insurance policy issued by Bellefonte for each of the premises (First, Third and Fifth causes of action), loss of rental (Second, Fourth and Sixth), debris removal (Seventh) and attorneys' fees (Eighth). Bellefonte in addition to its general denial alleged the affirmative defenses of breach of the protective maintenance clause, willful misrepresentation in connection with Bellefonte's investigation, failure of the Eighth cause of action to state a claim, and finally, failure to maintain the sprinkler system in the buildings as an increase of hazard suspending the coverage of the policy.

The action was tried by skilled and courageous counsel, one of whom was forced to interrupt the trial for heart surgery. In twenty-five trial days spread perforce over eight months, twenty-eight witnesses were presented as well as a substantial number of exhibits. Early in the proceedings, the selected jury was waived, and the evidence presented to the court. Final submissions were completed over a year after the commencement of

the taking of testimony in September, 1981. The proceedings were greatly aided by the skilled diligence of expert counsel who were comfortable and familiar with the issues and each other, a familiarity which enhanced the vigor of their presentation to the benefit of the court.

### THE FACTS

In 1977 Fine contracted to purchase three buildings, 649, 653 and 657 Broadway for \$1.3 million. The buildings were three contiguous five and six-story buildings with a stylistically unified marble and cast iron facade. They were located on the west side of Broadway in an area of lower Manhattan known colloquially as "NO-HO" (north of Houston Street). Their width varied from forty feet to fifty feet and they were uniformly two hundred feet deep, bordering on Mercer Street. There were separate addresses and elevators on the Mercer Street side. In total the buildings comprised approximately 158,000 square feet of space, above grade level (plus basements and subbasements), which had been divided into approximately seventeen lofts. The three buildings were operated as one and heated by one boiler located in the basement of 653 Building. Title passed to Fine in June, 1978.

The buildings originally were operated as the flagship store of the W & J Sloane Department Store in the late 19th Century, when that store led a move of merchants uptown, and contained many architectural details typical of the age, high ceilings, fenestrations, arches, facades, and a Victorian interior with wood and plaster decoration. The buildings were of stone construction and for the past twenty years had been leased to light manufacturing and some residential tenants. In 1978 and 1979 the buildings were occupied by tenants engaged in light manufacturing, warehousing, and in a few instances by artists in residence. The buildings were zoned for residential usage, and met the height and size, air and light requirements of the City for residential use.

Prior to purchase, Fine had retained an architect to determine and advise them of the feasibility of converting the build-

ings to residential occupancy, either as cooperative, condominium or rental apartments. Toward this end, the buildings were purchased, plans were drawn and filings made with the Attorney General's Office and the New York City Building Department, including but not limited to a presentation of the plans of conversion, applications and proposals. Fine had been granted a J-51 designation which carried with it certain tax benefits if a conversion to residential use was undertaken.

After the purchase Fine sought to obtain insurance covering thirty-one properties, of which 649, 653 and 657 were considered "key" by the underwriter. Kerwick & Curran ("K & C") were the insurance brokers consulted by Fine. They in turn sought to obtain the insurance from Bellefonte, a Delaware insurance company not admitted in New York, the underwriter for which had offices in Texas. Representations were made by K & C on behalf of Fine, and on October 3, K & C telexed to Bellefonte confirming coverage and other details with the expectation that the policy would be issued. There is no dispute with respect to terms of Bellefonte Underwriters Policy No. F-122374 issued to Martin Fine, William Becker and Philip Becker, et al, ("the Policy") except as to the increased hazard clause. The Policy was issued by Bellefonte on November 7, 1978, noting an inception date of October 11, 1978. The required premiums were paid.

The Policy provided:

" . . . this Company . . . does insure the insured named above and legal representatives, to the actual cash value of the property at the time of loss . . . ."

The Supplemental Declarations Endorsement states:

Location of premises, as stated in the Declarations, is extended to include the following and insurance is provided with respect to those premises described below:

# A-5

24	649-51 Broadway New York, NY	Apts. & Merc.	Bldg. Rents Sprink Lkge.	400,000 40,000
	Mortgagee: Citibank, N.A., 399 Park Ave., New York, N.Y.			
25	653-5 Broadway New York, N.Y.	Merc. Mfg. Loft	Bldg.  Rents Sprink. Lkge.	600,000  60,000 67,000
	Mortgagee: Citibank, N.A., 399 Park Ave., New York, N.Y.			
26	657-9 Broadway New York, N.Y.	Merc. Mfg. Loft	Bldg.  Rents Sprink Lkge.	700,000  50,000 78,000
	Mortgagee: Johanna Zuckerman, 10 West 33rd St., New York, N.Y.			

The policy proposed by K & C on October 26 contained a "Clause 14" which follows:

## 14. Protective Maintenance.

It is warranted that the insured shall maintain in complete working order such protective systems and warning devices as existed at time of attachment of this policy, or which the insured has agreed to install, insofar as it is under insured's control or supervision, and that no changes shall be made in the said protective systems and warning devices without the consent in writing of this company.

Additionally, the policy, in New York standard form, contained the following provision:

Conditions suspending or restricting insurance. Unless otherwise provided in writing added hereto this Company shall not be liable for loss occurring (a) while the hazard is increased by any means within the control or knowledge of the insured.

The policy as issued also contained a Paragraph 16:

*Privileges Granted:*

To construct additions and to make alterations and repairs to the building(s) at the location(s) specified herein and to erect new buildings and structures at such location(s).

However, the proposal forwarded in October by K & C contained a Clause 16, *Permits and Agreements*, which would have granted permission for "existing and increased hazards."

K & C complained to Bellefonte with respect to the change in Clause 16 in the Policy as issued from their proposal for increased hazard. Telephone conversations were exchanged. On January 18, 1979 Bellefonte issued an Endorsement No. 3 which contained the following language:

It is hereby understood and agreed paragraph 16. *Privileges Granted* contained in the policy is deleted in its entirety and the wording below is substituted therefor:

16. *Permits and Agreements*: Permission granted (a) for such use of the premises as is usual and incidental to the business conducted therein and for change in use or occupancy except as to any specific hazard, use or occupancy prohibited by the express terms of this policy or by any endorsement thereto; (b) to keep and use all articles and materials, usual and incidental to said business in such quantities as the exigencies of the business require; (c) for the building(s) containing property covered hereunder to be in course of construction, alteration, or repair, all without limit of time, but without extending the term of this policy, and to build additions thereto, and this policy, under

its respective item(s) shall cover such additions in contact with such building(s).

This insurance shall not be prejudiced (1) by any act or neglect of the owner of the building(s) if the insured is not the owner thereof, or by any act or neglect of any occupant of the building(s) other than the named insured, when such act or neglect of the owner or occupant is not within control of the named insured; (2) by failure of the named insured to comply with any warranty or condition contained in any form, rider or endorsement attached to this policy with regard to any portion of the premises over which the named insured has no control.

No further correspondence or communication was had on the subject until after February 14, 1979, the date of the fire.

After purchasing the buildings Fine placed their day-to-day management in the hands of Horatio Management Co., the business of which was conducted by George Peters, its managing agent. Alex Aloisio ("Aloisio") remained the superintendant at 649, 653 and 657. In order to get possession of the buildings for conversion, Fine did not renew expiring leases, and by February 1979 only one-third of the building was occupied on short-term leases. Changes in the operation of the heating system were adopted, which might be characterized as a "freeze-out" policy, are more fully described below.

The sprinkler systems in 649 and 653 were wet pipe constant pressure systems, that is, systems filled with water under pressure when not in use. There was a gravity tank on the top of 653, with a 10,000 gallon capacity, which sat atop of a pressure tank of 6,500 gallon capacity under 75 pounds of pressure per square inch which was in an enclosed and heated portion of the building from which down risers extended into the basement. There was a connection with a line which came in from the siamese fittings outside the building, fittings which enable the Fire Department to connect a hose line to the fittings and pump water into the system if all was working properly, which it did not on the night of February 14, 1979. The basement intercon-



nections at the time of the fire between the 649 and 653 systems and the lines coming from the street siamese connections were never established. 657 had its own separate sprinkler system.

Risers took the water from the basement to the sprinkler system on each floor which consisted of sprinkler heads and pipes suspended from the ceiling. In the event of a temperature exceeding 160-165 degrees, the sprinkler heads would fuse and open, and the head would distribute all the water in the pressure and gravity tanks. The system would continue to operate after the tanks were exhausted if fed by the Fire Department through the siamese fittings outside the building. Such a system normally serves to retard a fire sufficiently to permit its extinguishment in almost all conditions experienced by the New York City Fire Department except where arson is involved. The number of sprinkler heads per square feet were well above an industry minimum of one sprinkler head for every 64 square feet.

This sprinkler system was monitored by three controls, one on the water tank on 653 which would electronically sense a drop in pressure in the pressure tank and send an alarm to a central station, a second control which was activated by a drop below freezing on the water tank on 657, and most significantly, as it turned out, a water flow alarm sprinkler system in the basement of 653. The signals relating to 649 and 653 were leased from Honeywell Protective System, Inc. and those for 657 from AFA Protective Systems, Inc. The water flow alarm in the basement was operated by a flow of water across the extended flexible paddles of a Potter valve, bending the paddles and thus completing an electrical circuit which then transmitted an alarm over leased wires to the central station which in turn transmitted the alarm to the Fire Department whenever it was deemed appropriate to do so. There were no outside contractors with a duty to maintain the sprinkler system.

After the purchase of the buildings by Fine no changes were made in this system. Aloisio was licensed by the City to perform sprinkler maintenance, had done so before Fine's purchase, but had not made any inspections since the date of purchase. A

report of an inspection by the Fire Department of the sprinkler system in the fire buildings on October 30, 1978, which was three weeks after the inspection and one week before the Policy's issuance, indicates that the system on that date was found to be "satisfactory."

However, the new owners did make changes in the operation of the heating system by reducing the temperature range of the heat timer. This device measured the outside temperature and turned on the boiler whenever the temperature was within a specified range. Under the prior owners the lower limit of the range was 40 degrees. Fine through his managing agent directed a change to a lower limit of 25 degrees, although in fact Aloisio set the temperature at 30 degrees. Aloisio also testified that there were internal controls limiting the periods during which the boiler operated, even if the boiler had been activated by the heat timer. Fine through his managing agent instructed Aloisio to turn off the heating from 11:00 a.m. to 2:00 p.m. and Aloisio implied that there were additional restrictions on the time during which the heating system operated. The testimony as to the details of this restriction were unclear.<sup>1</sup> As a consequence of the heating policy adopted by Fine, there were consistent complaints from the tenants about the lack of heat. It is a fair inference that Fine sought to minimize his expenses and to discourage his tenants in an effort to gain control of the buildings for renovation into a more profitable use, and that this freeze-out policy had had some effect in that regard. However, there was no testimony that these changes in the operation of the heating plant in the building were outside of acceptable industry standards or were such that a reasonable person would anticipate that the water contained in the sprinkler system would freeze.

From January on in 1979 the weather was particularly cold and during this period the boiler functioned properly, until February 6. Then the boiler failed to operate principally because of electrical problems which were repaired by the replacement of fuses, an occurrence which was repeated on the 7th and 8th and resulted in a change of wiring on the 9th.<sup>2</sup>



The temperature ranges from February 1, 1979 to February 14, 1979 were as follows:

<i>February Date</i>	<i>Maximum</i>	<i>Minimum</i>	<i>Average</i>
1	30	22	26
2	33	22	28
3	36	24	30
4	41	25	33
5	28	18	23
6	29	16	23
7	25	22	24
8	34	20	27
9	24	9	17
10	21	6	14
11	16	3	11
12	19	5	12
13	19	6	13
14	17	3	10

A number of tenants complained about inadequate heating and the necessity of wearing heavy clothing in order to keep warm.

On February 11, 1979 in the early hours there was a fire in the Infinity Discotheque which occupied the basement of 653. The sprinkler system operated, an alarm was received, the Fire Department was notified and responded. There was no substantial damage. Later that day Aloisio received a call from Honeywell concerning a signal it had received due to a manual fire alarm for building 653 (this being the result of a small fire in the first-floor hallway adjacent to the premises occupied by Infinity Disco). At that time, Aloisio spoke with personnel of Allen Sportswear, Inc. which occupied premises in 657, who informed him that, as he himself observed, the building was without heat.

The following Monday, February 12, Aloisio observed frozen radiators near the windows on the third floor of 649. He also learned that water was leaking from the condensation pumps in the basement of 657 and, in order to avoid losing water from the heating system for the other buildings, he shut off the king valve which supplied steam from the boiler to building 657. He deter-

mined that the water was leaking from the condensation pump because water in the heating pipes had frozen. From that time on, about 3:30 p.m. on February 12, 1979, until the fire, near midnight on February 14, no heat whatsoever was supplied to 657. However, according to Aloisio, the boiler functioned on February 12, 13 and 14.

On the morning of February 14, a sprinkler head near a window on the fifth floor of 649 froze and began to leak. Aloisio informed the central station that repairs would be undertaken, and the sprinkler on that floor was shut off during the period of repair.

At 11:54 p.m. on February 14, 1979 a sprinkler flow alarm was received at Honeywell headquarters. The Fire Department was notified and responded. When Battalion Chief Lee approached the building from the Broadway side he saw a certain amount black smoke issuing from the 3rd floor of 653 which indicated to him that a substantial fire was in progress.

Chief Lee in company with Lt. Nixon of Ladder Company 9 went to the fire floor, covered by a hose line and forced entry into the space leased to Lion Leather. After crawling some forty feet into the space, the smoke followed by the heat grew so intense that Chief Lee and the men of Ladder 9 were forced to leave the floor. Both Chief Lee and Lt. Nixon of Ladder 9 agreed that the heat was sufficient to have fused the sprinkler head and that the sprinkler was not operating.

Chief Lee went out to the landing, down the stairs, and out to the street where he noticed Engine Company 33 had lines into the siamese fittings of 653 and 649. Since he believed the line to be charged, that is, filled with water under pressure from the pumper, and since he had observed no sprinkler discharge when he was on the fire floor, he then went to the basement seeking to locate a main valve with the expectation that the main valve had been shut. He failed in this undertaking. Some distance from the Broadway side of the building in the basement he heard a churning noise which he believed to be a block in the sprinkler line. Chief Lee after being advised that the pumper was overheating directed the men in Rescue Co. No. 1 to

continue the search for the main valve. Chief Lee returned to the street to supervise the effort to contain the fire which continued to spread.

Rescue Co. No. 1 evacuated tenants from the fifth floor of 649 by ladder, having found it impossible to enter the building. Within the first fifteen to twenty minutes all hands were engaged in fighting the fire, successive alarms had been given, and Chief Lee had been relieved from overall responsibility by higher ranking officers who had arrived at the scene. The fire continued substantially unabated in 649 and 653 until the following morning. The buildings were almost completely burned out by the time the fire was extinguished. 657 was relatively unharmed, except for smoke and water damage.

No sprinkler was observed to operate by any fireman in 649 and 653, notwithstanding the operation of the sprinkler flow alarm at 11:54 which gave the first alarm of the fire. The Fire Department reports establish the standpipe system in 657 operated and was not frozen.

A great deal of testimony was taken from the firemen present and from the experts from both sides. Most persuasive was the eye-witness testimony of the fire fighters and the testimony of experts on sprinkler operation, including the fire fighters, which established that had the sprinklers functioned normally, the fire could have been controlled.

As a result of the extent of the fire, there was no tangible evidence by which the reason for the failure of the sprinklers could be established. Various theories were advanced, that the tank on 653 was frozen (the tank on 657 apparently did not freeze, no alarm having been received), that the down risers froze (the water flowed to activate the sprinkler flow alarm and the 657 standpipes were not frozen), that there was a blockage in the basement (the sprinklers in neither building operated), and that the sprinkler system on the fire floor was shut off by an arsonist (there was no evidence that the sprinklers worked on any floor of 649 or 653). After all the Fire Department reports had been completed, a critique of the operations of the Department during the fire was held by officers of the Department,

and it was concluded tha the origin of the fire was incendiary. Here again, however, the inconsistency of the operation of the water flow alarm remained unresolved.

The most persuasive theory advanced is either that the system was partially blocked by ice and that when the fire melted the sprinkler heads on the third floor there was enough fluidity in the system for some water to flow, enough to activate the alarm in the basement (an undeniable event), but that thereafter the system became blocked, presumably by ice, so that when Chief Lee arrived in the basement, he heard a churning noise that resulted when the water supplied by the pumpers on the street failed to proceed through the system because of the block. Indeed Chief Lee sought, but failed to locate, the shut-off valve, believing as he did at the time of the fire that perhaps the entire system had been turned off as indeed it had been at one time, since on the afternoon of the February 14, plumbers working in 657 had shut off the king valve.

It is plausible that the furnance broke down on the evening of February 14 as it had previously on the occasions described, and because of the extreme temperature, the sprinkler system froze at least partially, not enough to prevent the flow alarm to operate initially but sufficiently to block the line after a brief initial flow. It is also possible to infer that there was a frozen section in the lines above the third floor between the tanks and the water flow alarm with the result that the release of pressure from a fused sprinkler on the third floor of 653, the fire floor, caused turbulence in the line and a release of pressure downstream of the paddles in the potter valve sufficient to activate the water flow alarm.

However, because of the state of the physical evidence, the confusion of the events during the progress of a major fire and the lack of specific facts, as opposed to inference with respect to the cause of failure of the sprinkler system, Bellefonte has failed to establish by a preponderance of the evidence that Fine's heating practices were a proximate cause of the failure of the sprinkler system to work. Indeed, the combination of the operation of the flow alarm and the failure of the sprinkler system

constitute an unsolved puzzle, a riddle to which no preponderant answer has been supplied.

In addition there was insufficient evidence from which it could be found that Fine's heating practices violated any established norm. There was evidence uncontroverted that the heat timer operated and that the outside temperature was such as to have activated the furnace. Although Bellefonte urges that the boiler was shut off during 55 minutes of each hour, no record citation of the assertion has been found, and there is no direct statement to this effect in the testimony of Peters or Aloisio, the only two witnesses with direct knowledge of the heating practice employed after Fine's purchase of the buildings. While the buildings were underheated in terms of comfort, there was no testimony that a freeze-up could reasonably have been anticipated in light of customary practices.

Under the Policy, Bellefonte had the right to investigate and compel the examination of the insured concerning the loss. This examination was conducted and George Peters testified on November 27, 1979 and Martin Fine on August 3 and 30, 1979.<sup>3</sup> Their testimony was false with respect to the limits set on the heat timer, both having testified that the lower limit of the range was 40 degrees while Aloisios testified, correctly I find, that the lower setting was 30 degrees and that he had been instructed to set the lower limit at 25 degrees. Since Aloisio was a credible, although occasionally confused witness, and since he was the individual who actually did the tasks about which the testimony was given, his version is credited.

Also both Fine and Peters testified that Aloisio was charged with sprinkler maintenance, while Aloisio on the stand stated that he had not been given any instructions in that regard and in fact had not made the inspections and maintained the records as he had done under the direction of the prior owner of the building. Again, I credit Aloisio as the person with the direct responsibility, and find Peters and Fine's statements with respect to sprinkler maintenance to have been inaccurate and consequently false.

There is little dispute as to the facts relating to the "actual cash value at the time of the loss" of the buildings, but of course, there are widely differing views as to the implication of these facts. In November, 1979 a contract of sale was executed calling for the purchase of the buildings for \$1.3 million, a transaction which was completed the following June. In June of 1979, the buildings in their demolished condition (the facade alone having been preserved) were sold for \$2.0 million.

The price per square foot of comparable properties sold in the area is \$16-18 per square foot as testified to by Bellefonte's expert whose testimony was credible and persuasive. Using a square footage of 151,717, the fair market value on that basis amounted to \$2.5 million, a considerable increase over the arms length transaction less than a year before. Testimony was presented that real estate prices continued to rise during the period in question, testimony which was unchallenged but also imprecise. Fine's expert, using different sales and properties but basically the same type of analysis, concluded that the property had a fair market value of \$3,680,000.

The property was properly zoned for a conversion to an apartment dwelling and it had been granted a J-51 designation which would apply even after the fire. The property had unique architectural qualities, as described above. The property operated at a loss of \$31,000 in 1978. The net profit after conversion projected by Fine was \$4.5 million.

Using tax assessment ratios and other considerations, the valuation experts estimated the ratio of land to building value to be from 33% to 41% of the market value.

It was undisputed that the cost to replace the buildings estimated at \$1.5 million for 649 and \$2.0 million for 653 exceeded the policy limits, and Bellefonte does not urge a replacement cost limitation on the court.

Relying on the range provided by the experts, I find that 37% of the total value is attributable to land and that such a ratio appropriate and within industry standards. I also find that based upon comparable market values, the market value of the land and property on February 14, 1979 was \$2,500,000.



## CONCLUSIONS OF LAW

There are seven issues of law to be resolved in light of the facts as found above:

1. Did false swearing void the Policy?
2. Which Clause 16 applies and does it make Clause 14 inapplicable with respect to a freeze-up?
3. Did Clause 14 operate as a warranty?
4. Was Clause 14 violated?
5. Was the hazard increased in violation of Clause 16?
6. What is the measure by which the "actual cash value" is determined?
7. Was Bellefonte's conduct vexatious and without reasonable cause?

For the reasons set forth below I conclude that the false swearing did not void the insurance policy, that Clause 16 as set forth in Endorsement No. 3 is applicable, that Clause 14 is a warranty, that it was not violated, that the hazard was not increased in violation of Clause 16, that actual cash value of the buildings is \$1,575,000 and that Bellefonte's conduct has not been vexatious or without reasonable cause.

## THE FALSE SWEARING

Bellefonte has urged that the policy is void as a result of the false testimony given by Fine and Peters in the course of the investigation of the loss pursuant to the Policy. Viewed most charitably, Fine and Peters were mistaken in their testimony. Both testified falsely that the nighttime setting for the heat timer was 40 degrees as I have found above, but the matter does not end there.

The relevant provision of the Insurance Law § 168(6) (McKinney 1966) provides that the form of the standard fire insurance policy shall include the following paragraph:

*Concealment, fraud.*

This entire policy shall be void, if whether before or after a loss, the insured has willfully concealed or misrepresented any material fact or circumstance concerning this insurance or the subject thereof, or the interest of the insured therein, or in case of any fraud or false swearing by the insured relating hereto.

From the plain language of this provision, the resolution of the affirmative defense of fraud turns on the materiality of the fact concerned, simply its falsity or inaccuracy. *See also Claflin v. Commonwealth Insur. Co.*, 110 U.S. 81, 94 (1883) (a false answer must be "material to the inquiry."); *Werber Leather Coat Co. v. Niagara Fire Insur. Co.*, 254 A.D. 298, 299, 5 N.Y.S.2d 1 (2d Dep't. 1938) (must find a "willful misrepresentation of a material fact"); *Oppenheimer v. Washington Assurance Corp.*, 244 A.D. 234, 235, 278 N.Y.S. 298 (1st Dep't 1935) (must find "concealment and misstatement under oath of material facts"); 31 N.Y. Jur. § 1298 (must find "false statements willfully made with respect to a material matter").

Here the statements were not material to the investigation. Given the extreme temperatures during the period from February 5th to February 14 as noted above, whether the heat timer setting was 25 degrees, 30 degrees or 40 degrees would not have affected the operation of the heating system. Further there was no testimony that a 25 degree or 30 degree setting would have constituted a practice which would have reasonably been foreseen to result in a freezing condition, which, in turn would have made the sprinkler system inoperative.

Similarly with respect to the sprinkler maintenance issue, whether Aloisio was instructed to perform maintenance on the sprinkler system or not, in fact he did take the action necessary to repair the system, and there is no indication in this record that any failure of record keeping or regular maintenance was in any way responsible for the freeze-up. Since the Fine policy of freeze-out has not been proved to be the cause of the freeze-up, the false statements, viewing them as such, were not material as contemplated under section 168.



## THE APPLICABLE CLAUSE 16 DOES NOT BAR THE AFFIRMATIVE DEFENSE BASED ON CLAUSE 14

In an effort to counter Bellefonte's breach of warranty affirmative defense, Fine seeks to rely on the "Permissions and Agreements" clause proposed by K & C in October, 1978, claiming that any additional hazard such as the freeze-up of the sprinkler system was exempted by that clause and that Fine never agreed to the substituted Clause 16 contained in the Policy.

The Policy on its date of issuance was in proper form, and at no time was it rejected, nor was the repayment of the premiums sought, nor any action taken to cancel the Policy. However, renegotiation of Clause 16 was sought by Fine through its insurance broker and objected to by Bellefonte, by way of a third version. Fine, after initiating renegotiation, never objected to that version.

Such action fails to establish the October version proposed by K & C as the controlling provision, and if anything, establishes that the final version became part of the policy. *Cf. Mellor v. Budget Advisors, Inc.*, 415 F.2d 1218 (7th Cir. 1969) (ratification of contract results if party who has executed contract under duress remains silent or acquiesces in contract); *Security Underground Storage Inc. v. Anderson*, 347 F.2d 964 (10th Cir. 1965) (where party to contract remains silent as to claimed invalidity of contract and continues to treat as his own property which was subject of contract, he will be deemed to have waived his objection and will be bound by instrument); *Gateway Co. v. Charlotte Theatres*, 297 F.2d 483 (1st Cir. 1961) (buyer sent contract back to seller with cover letter directing attention to a modifying proposal to which seller did not respond and court held that parties had modified their original contract). Therefore I conclude that from October 11, 1978 to January 9, 1979, the Policy was in effect as written and after January 9, in effect as modified by Endorsement No. 3. There is no serious contention by Fine that Endorsement No. 3 vitiates the requirements of Clause 14.

## CLAUSE 14 WAS A WARRANTY

As found above, the applicable clause relating to protective maintenance was as follows:

14. *Protective Maintenance.* It is warranted that the insured shall maintain in complete working order such protective systems and warning devices as existed at time of attachment of this policy, or which the insured has agreed to install, insofar as it is under the insured's control or supervision, and that no change shall be made in the said protective systems and warning devices without the consent in writing of the company.

In New York the enforceability of such a warranty is governed by Insurance Law § 150 (McKinney 1966). Section 150(2) provides as follows:

No breach of warranty shall avoid an insurance contract or defeat recovery thereunder unless such breach materially increased the risk of loss, damage or injury within the coverage of the contract.

As observed in *Glickman v. New York Life Ins. Co.*, 291 N.Y. 45, 51, 50 N.E. 2d 538 (1943) "in section 150 the Legislature was seeing to it that a policy of insurance will not be avoided by proof of an immaterial 'breach of warranty.'" A breach of the warranty clause as applied to the sprinkler system in the subject buildings would be material. See *Irv-Bob Formal Wear Inc. v. Public Service Mutual Ins. Co.*, 81 Misc.2d 422, 366 N.Y.S.2d 596 (Civ. Ct. Queens County 1975), *aff'd* 86 Misc.2d 1006, 383 N.Y.S.2d 832 (App. Term 1976).

The warranty in this instance is promissory in character and although it does not specifically provide that the policy will be voided or the coverage suspended in the event of a breach of the warranty, a material breach would result in a forfeiture of the policy coverage notwithstanding the absence of such a "forfeiture clause." See *Appleman, Insurance Law and Practice*, Vol. 12A, § 7355 (1981).

Fire insurance policies have been held void due to a violation of a clause requiring:

that, insofar as the sprinkler system and water supply therefor are under the control of the Insured, due diligence shall be used by the Insured to maintain them in complete working order.

*Buehler Corp. v. Home Ins. Co.*, 358 F.Supp. 15, 16 (S.D. Ind. 1973), *aff'd* 495 F.2d 1211 (7th Cir. 1974). Failure to maintain the sprinkler system in operative condition was also deemed a material breach sufficient to void an insurance contract in *Bd. of Educ. of Charles County v. St. Paul Fire & Mar. Ins. Co.*, 420 F.Supp. 491 (D.Md. 1975), *aff'd* 544 F.2d 751 (4th Cir. 1976).

No particular form of words is essential to the creation of a warranty in an insurance contract. Any statement or description which relates to the risk, particularly if (as in this case) it is expressed as a warranty, will be enforced as a warranty. 30 N.Y. Jur. Insurance § 928. It is stated in 12A Appelman, *Insurance Law and Practice* § 7355 that:

Where a statute requires materiality to be shown upon a breach of warranty, this result will follow if the matter is material though no forfeiture clause is present, although the breach of an immaterial provision will not matter, the statute expressly requiring in that event that a provision for avoidance be shown to exist.

The principle enunciated in Appelman above is explicitly applicable under Insurance Law § 150.

The courts of this state have consistently held that the consequence of a material breach of warranty is to defeat recovery without regard to whether or not such a consequence is explicitly spelled out in the policy. See *Clemans v. Supreme Assembly Royal Society of Good Fellows*, 131 N.Y. 485, 30 N.E. 496 (1892); *Sirvint v. Fidelity & Deposit Co. of Maryland*, 242 A.D. 187, 272 N.Y.S. 555 (1st Dep't), *aff'd per curiam*, 266 N.Y. 482, 195 N.E. 164 (1934); *Graley v. American Eagle Ins. Co.*, 235 A.D. 490, 257 N.Y.S. 566 (4th Dep't 1932); *Fidelity & Casualty*

*Co. v. Codelle*, 25 Misc. 2d 472, 207 N.Y.S.2d 846 (Sup. Ct. N.Y. County 1960). Since Clause 14 under this authority must be considered a warranty, the next inquiry must be directed to Bellefonte's claim of breach.

### **THERE WAS NO BREACH OF WARRANTY**

Under the facts found above, Bellefonte has failed to establish that the Fine freeze-out policy resulted in a freeze-up on February 14 which prevented the operation of the sprinkler system. Perhaps that result was produced by a boiler malfunction, an arsonist's act, a plumber's mistake, together with the extreme temperature. The evidence was not preponderant that the low temperature policy Fine adopted, which undeniably caused discomfort to his tenants, resulted in the sprinkler system freeze-up, particularly in view of the operation of the standpipes in 657 and the non-activation of the heat alarm in its roof-top tank. Therefore Bellefonte failed to establish that protective maintenance clause was breached.

### **THERE WAS NO INCREASED HAZARD**

The policy provided that Bellefonte would not be liable for a loss occurring "while the hazard is increased by any means within the control or knowledge of the insured." Bellefonte on the eve of trial asserted an affirmative defense based on this clause and asserted that the freeze-out policy resulted in an increase in hazard, or in the sprinkler system malfunction, which bars Fine's recovery.

In *Plaza Equities Corp. v. Aetna Casualty and Surety Co.*, 372 F.Supp. 1325, 1331 (S.D. N.Y. 1974), the court stated:

An increase of hazard occurs only when the insured performs acts which are *reasonably calculated to increase the risk* and which he knows or should know will increase the risk. The negligence or misjudgment of the insured . . . is insufficient (emphasis added).

Similarly, Appelman explains that:

An increase of hazard occurs when the insured is guilty of some act or acts *reasonably calculated to increase the risk, and which actually did increase it* . . . (emphasis added).

*Appleman, supra*, at vol. 5, § 2941. Had there been evidence that the sprinkler system was inoperative and that Fine had no intention of fixing it, a finding of increased hazard might have been in order. *Cf. Brooks Upholstering Co. v. Aetna Insurance Co.*, 149 N.W.2d 502 (Sup. Ct. Minn. 1967) (although new trial granted, finding of increased risk of loss by fire indicated that jury had found that a sprinkler system and been turned off and intentionally left off). However, such is not the case here. There was no testimony that the change in heating policy could have been anticipated to make the sprinkler system inoperative. Indeed, the system had functioned during the fire at the discotheque on February 11; there was water leakage on the fifth floor at 649 the day of the fire in question; and Aloisio testified that the sprinkler system was operative on February 14th.

As indicated earlier, the burden of proof to establish this defense falls upon Bellefonte and it has not been met. Bellefonte has failed to establish the type of increased hazard which would vitiate the policy under the cited authorities.

## THE MEASURE OF ACTUAL CASH VALUE

The policy provided:

. . . this Company . . . does insure the insured named above and legal representatives, to the *actual cash value* of the property at the time of loss. . . . (emphasis added).

The policy this involved is an "Open Policy" as opposed to a "Valued Policy." 1 G. Richards Law of Insurance, § 21 at 74-75 (5th ed. 1952). The fundamental difference between a Valued Policy and an Open Policy is explained as follows:

[T]he Valued Policy estimates not merely the value of the property or interest insured, but values the loss

and is equivalent to an assessment of damages, or perhaps is in the nature of liquidated damages-in case of total loss of the property. This definite valuation is placed upon the insured property, presumptively after a preliminary inspection and appraisal of the property by the insurer.

On the other hand, the Open Policy is a contract in which a certain agreed upon value or sum, written also on the face of the policy, is only the maximum limit of recovery in case of loss of the insured property; the amount of recovery is necessarily the "actual cash value (ACV) at the time of loss," which sum or value represents true indemnification for the loss sustained. Under an Open Policy, which is by far the prevailing form of property insurance contract, the insurer is permitted to introduce evidence that the property was over-insured or that the agreed upon sum represents more than the true worth of the property.

*Id.* (footnotes omitted). As stated in *Valuation and Measure of Recovery under Fire Insurance Policies*, 49 Colum. L. Rev. 818 (1949): "Unless the policy is valued, the sum set forth upon its face is intended merely as the maximum limit of the insurer's liability, not the measure of it."

In *McAnarney v. Newark Fire Insurance Co.*, 247 N.Y. 176, 159 N.E. 902 (1928) the Court of Appeals stated: "We interpret 'actual cash value' to have no other significance than 'actual value' expressed in terms of money." *Id.* at 181. The court then continued:

Indemnity is the basis and foundation for all insurance law. (*Castellain v. Preston*, 11 Q.B.D 380; Richards on *Insurance Law*, p.27; Wood on *Fire Insurance*, sec. 471). "The contract of the insurer is not that, if the property is burned, he will pay its market value, but that he will indemnify the assured, that is, save him harmless or put him in as good a condition, so far as practicable as he would have been in if no fire had



occurred." (*Washington Mills Mfg. Co. v. Weymouth Ins. Co.*, 135 Mass. 503). . . . To insure is "to guarantee or secure indemnity for future loss or damage." (*The Century Dictionary*.) Where insured buildings have been destroyed, the trier of fact may, and should, call to its aid, in order to effectuate complete indemnity, every fact and circumstance which would logically tend to the formation of a correct estimate of the loss. It may consider original cost and cost of reproduction; the opinions upon value given by qualified witnesses; the declarations against interest which may have been made by the assured; the gainful uses to which the buildings might have been put; as well as any other fact reasonably tending to throw light upon the subject (*Sedgwick on Damages*, sec. 722; *Wood on Fire Insurance*, sec. 472; *State Insurance Co. v. Taylor*, 14 Colo. 499; *Citizens' Bank v. Fitchburg Fire Ins. Co.*, 86 Vt. 267; *The H. F. Dimock*, *supra*; *Washington Mills Mfg. Co. v. Weymouth Ins. Co.*, *supra*; *Shattuck v. Stoneham Branch R.R. Co.*, 6 Allen, 115; *Swan v. Middlesex Co.*, 101 Mass. 173; *Wigmore on Evidence*, sec. 1943).

*Id.* at 184-85.

In *Sebring v. Firemen's Insurance Co.*, 227 A.D. 103, 237 N.Y.S. 120 (1929) (per curiam), the Appellate Division, in reversing a judgment for the plaintiff, stated:

"Actual cash value" means "actual value" expressed in terms of money. That real value constituted the measure of damages to which plaintiff was entitled, if he was entitled to anything. (*McAnarney v. Newark Fire Ins. Co.*, 247 N.Y. 176).

Cost of reconstruction of the burned buildings, less depreciation, is one of the elements which go to make up "actual value." It is not, however, the exclusive and only method by which that value can be ascertained. The trier of the fact, charged with the duty of ascertaining the damages which an insured has sus-

tained when his buildings have been burned, is entitled to consider for what it is worth any fact which reasonably tends to throw light upon that subject. This would include the purchase price of the property, if it was bought within a reasonable period prior to the fire, the opinion of experts as to its value, etc.

*Id.* at 103-04. The court then concluded:

"The learned trial court excluded certain evidence offered by appellant which we think tended to shed some light on the question of value, and which the jury would have had a right to consider had it been in the case. This, we think, was error. We also think that the learned court erroneously instructed the jury that, as matter of law, the reconstruction value of the building destroyed, less depreciation, was the measure of damages to which the plaintiff was entitled. That was not the exclusive method by which plaintiff's damages could be ascertained. The jury could have taken into account any fact reasonably tending to shed any light on the question. We cannot say that these errors were harmless. For this reason, we think that the judgment appealed from should be reversed and a new trial granted.

*Id.* at 104.

In *Gervant v. New England Fire Insurance Co.*, 306 N.Y. 393, 118 N.E. 2d 574 (1954), the Court stated:

The Appellate Division was also correct in concluding, in view of our decision in *McAnarney v. Neward Fire Ins. Co.*, (247) N.Y. 176 that the "actual cash value" of premises under a standard fire insurance policy in this State cannot be arrived at by receiving evidence of replacement cost less depreciation only. Rather, the trier of fact should listen to all pertinent evidence on the subject. The insurer in that case had agreed to insure to the "extent of actual cash value." We interpreted that phrase to mean actual value ex-



pressed in terms of money and said (pp. 182-184): "We do not agree \*\*\* that, under the standard clause, the sole measure of damage was \*\*\*. This provision, while it doubtless comprehends cost of reproduction, does not restrict the field of investigation to such cost or provide that, with depreciation, it shall constitute an exclusive measure of recovery."

306. N.Y. at 398.

More recently, in *Incardona v. Home Indemnity Co.*, 60 App.Div. 2d 749, 400 N.Y.S.2d 944 (4th Dep't 1977), it was held that:

[W]hile reproduction cost less depreciation is competent evidence of actual cash value in a fire loss, it is error to instruct the jury that reproduction cost less depreciation is the sole measure of actual cash value . . . Replacement cost or cost of repair standing alone is not sufficient proof of actual cash value.

*Id.* at 749-50.

The net effect of the application of the *McAnarney* rule was summarized by one commentator as follows: " 'Actual cash value' is defined by the New York Court of Appeals as the economic value of the building as distinguished from its replacement value." Note, *Valuation and Measure of Recovery under Fire Insurance Policies*, 49 Colum. L. Rev. 818, 822 (1949).

As these authorities make manifest, "actual cash value" at the time of the loss is an artificial, arbitrary valuation, requiring consideration of any relevant factor and the resolution of the conflicts presented by such factors. Here the facts were established, as set forth above, concerning replacement cost, the J-51 designation and the applicable zoning, the architectural distinctions of the buildings, the market value of the property in June 1978 and June 1979, the ratios of the accepted building and land values, the income received from the property, projected profits, and the market value of comparable property.

Both appraisal experts agreed that the most useful analysis for valuation purposes to be threefold: cost of replacement, income

evaluation and market data (comparable sales). The age of the buildings made the cost of replacement generally an inappropriate measure, and it was agreed that such replacement cost was substantially in excess of the \$1.0 million limitation. The operation of the buildings at a loss in 1978 tends to diminish their value, while the anticipated profit on conversion produce the opposite result. Neither factor was relied upon to any considerable extent by any of the valuation experts and both are considered here to be of relatively little assistance in the determination which is required.

The square footage analysis of comparable values calculated by both experts on the basis of comparable sales include both land and building value, while the insurance policy applies only to the premises, the buildings, and therefore, the value of the land must be deducted from the total "actual cash value." The subsequent sale at \$2.0 million in light of the sale purchase for \$1.3 million the year before demonstrates amply that the land may well have been more valuable without the insured buildings, in this particular area of Manhattan, zoned as it was. In any case, since land is also involved in the comparability figures, further analysis is required.

Most relevant and useful among all the factors considered by the experts were the market value calculations based on comparable transactions, a method relied upon by both experts which included land value. Fine's expert considered the land value in the neighborhood of 33% of the market value and Bellefonte's expert testified 41% to be the appropriate percentage. In addition, because the properties had a grandfathered designation for J-51 treatment providing substantial reduction of taxes upon conversion, their market value was enhanced.

According to Bellefonte's expert who was entirely credible and most knowledgeable,<sup>4</sup> the property was worth \$2.5 million using comparable sales to fix value. Fine's expert attributed a market value of \$3,680,000 on a comparable value calculation. Bellefonte would seek to limit any recovery to \$500,000, taking the market value given by their expert of \$2.5 million less the sale price of \$2.0 million in June 1979 as the best criterion for

value. However, Bellefonte provides no support for the proposition that the subsequent sales price should be deducted in determining "actual cash value," a defined term in the Policy under which recovery is sought. Finally, at this stage, Bellefonte properly seems to have abandoned its earlier claim that since the policy covered loss and Fine made a profit on the sale in June 1979 over his acquisition cost, no recovery under the Policy was warranted.

I conclude under these circumstances and taking all the facts found above into consideration that the most appropriate measure of "actual cash value" is the market value of the properties on the day of the fire calculated on the basis of comparable values, namely, \$2.5 million, reduced by the value of the land calculated at a ratio of 37%, a ratio between those asserted by the two experts, who were not far apart on this issue. Thus the actual cash value of the premises at the time of the fire was \$1,575,000 and that Fine therefore is entitled to recover the entire policy of \$1.0 million.

#### **Additional Claims**

The difficulty of the issues presented to the court and all that has preceded in this opinion demonstrate that Bellefonte's conduct in refusing payment was not vexatious or without reasonable cause. Fine is therefore not entitled to attorneys' fees.

There are other items, the amounts of which are not in contention, to which Fine is entitled: \$150,000 for rental on 649 and 653 and 657; damage to 657 in the amount of \$214,221; and the expenses for debris removal of \$170,466.60.

Submit judgment on notice in accordance with this opinion within ten (10) days.

**IT IS SO ORDERED.**

DATED: New York, N.Y.  
December 29, 1982

/s/ \_\_\_\_\_  
ROBERT W. SWEET  
U.S.D.J

UNITED STATES COURT OF APPEALS  
FOR THE SECOND CIRCUIT

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Nos. 1547, 1548—August Term, 1982  
(Argued June 7, 1983                      Decided January 3, 1984)  
Docket No. 83-7188/98

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MARTIN FINE, WILLIAM BECKER and PHILIP BECKER,  
individually, and WILLIAM BECKER and PHILIP BECKER  
d/b/a BECKER & BECKER, all doing business as 649  
BROADWAY EQUITIES CO.,

*Plaintiffs-Appellees-Cross-Appellants,*

—v.—

BELLEFONTE UNDERWRITERS INSURANCE CO.,  
*Defendant-Appellant-Cross-Appellee.*

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Before:

OAKES and MESKILL, *Circuit Judges,*  
and HILL,\* *District Judge.*

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\* Honorable Irving Hill, Senior United States District Judge for the  
Central District of California, sitting by designation.

Appeal from a judgment of the U.S. District Court for the Southern District of New York, Robert W. Sweet, *J.*, granting recovery to the insured on a fire insurance policy despite a finding that the insured had testified falsely under oath in a post-fire examination because the false statements were not deemed to be "material".

Reversed.

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HERBERT P. POLK, N.Y., N.Y. (Robert S. Newman, of Whitman & Ransom, N.Y., N.Y., of counsel) *for Appellant.*

ANDREW C. JACOBSON, N.Y., N.Y. (Frank A. Weg, Dennis T. D'Antonio, of Weg Meyers & Jacobson, N.Y., N.Y., of counsel) *for Appellee.*

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HILL, *District Judge:*

In June 1978, Plaintiff, Fine,<sup>1</sup> purchased three contiguous parcels of land in New York City for a total price of \$1,300,000. Each parcel had a building on it. Though the buildings had separate addresses (649, 653 and 657 Broadway), they were also contiguous and were operated as a single economic unit. The three buildings had a single heating system which employed a single boiler.

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<sup>1</sup> The Plaintiffs in this action are Martin Fine, William Becker and Philip Becker, and William Becker and Philip Becker d/b/a as Becker and Becker. Plaintiffs collectively did business as 649 Broadway Equities Co. Plaintiffs collectively are herein referred to for convenience as "Fine".

Following the purchase, Fine, through a broker, obtained a policy of fire insurance covering the three buildings (and other properties) from defendant Bellefonte Underwriters Insurance Co. (hereinafter "Bellefonte"). The policy was in the standard New York form.

At the time of Fine's purchase, the buildings were occupied by commercial tenants, some artists, and others who conducted light manufacturing and warehousing businesses. Fine desired to convert the buildings to residential use. Toward that end, after buying the buildings, he did not renew most expiring leases and he engaged in a "freeze-out" policy designed to minimize expenses and discourage tenants from remaining. The heat timer which controlled operation of the boiler, based in part on outside temperature, was set so that it would not start up the heating system until a sub-freezing temperature was reached. Additionally, the superintendent was told to turn off the heating system entirely from 11 a.m. to 2 p.m. each day regardless of the outside temperature. By February 1979, when the fire occurred, only about one-third of the premises remained occupied.

On February 14, 1979, a fire of unknown origin occurred which started in the 649 and 653 Broadway buildings and spread to 657 Broadway. The buildings at 649 and 653 Broadway were totally destroyed except for their facades and the building at 657 Broadway was substantially damaged.

On the night of the fire the sprinkler system in the buildings, which was the main fire protection device, did not operate. The sprinkler system was of the so-called wet pipe constant pressure type. In this type of system, pipes within the building are filled with water which is under pressure from gravity tanks. In addition, there are fittings outside the buildings at street level to enable the Fire

Department to pump water from city mains into the system. The trial judge found that on the night of the fire, none of the sprinkler heads in the system worked. The Fire Department was unable to pump water into the system due to blockage in the pipes which the trial court found was "presumably" caused by ice. The trial court found that had the sprinklers functioned normally, the fire could have been controlled.

Fine submitted claims on the policy which Bellefonte, after investigation, denied. Bellefonte based its denial of liability on the assertion that three separate provisions of the policy had been breached, claiming that a breach of any one of the three would relieve it of liability. The three provisions were:

1. The so-called "Protective Maintenance Clause",<sup>2</sup> which is a warranty that "protective systems and warning devices" will be maintained in complete working order and will not be altered.
2. The so-called "Increased Hazard Clause",<sup>3</sup> which voids coverage if "the hazard is increased by any means within the knowledge of the insured."

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<sup>2</sup> The language of this policy provision is as follows:

*Protective Maintenance.* It is warranted that the insured shall maintain in complete working order such protective systems and warning devices as existed at time of attachment of this policy, or which the insured has agreed to install, insofar as it is under the insured's control or supervision, and that no change shall be made in the said protective systems and warning devices without the consent in writing of this company. (App. p. A-260)

<sup>3</sup> The language of this policy provision is as follows:

Conditions suspending or restricting insurance. Unless otherwise provided in writing added hereto this Company shall not be liable for loss occurring (a) while the hazard is increased by any means within the control or knowledge of the insured . . . . (App. p. A-262)



3. The so-called "False Swearing Clause",<sup>4</sup> which provides that coverage is voided if, before or after a loss, the insured has willfully concealed or misrepresented any material fact concerning the insurance or the insured property, or in the event of any "fraud or false swearing by the insured" relating to any such material fact.

Fine filed the instant action against the insurer for payment of the loss. After a lengthy court trial, the trial court found in favor of Fine and against the insurance company and awarded a judgment of \$1,214,221 for damage to the buildings<sup>5</sup> plus additional sums of \$150,000 for loss of rental and \$170,446.60 for debris removal. Bellefonte appeals, asserting that the trial court's failure to sustain each of its three separate defenses involved an error of law and was against the weight of the evidence. If, *arguendo*, Bellefonte is found liable, it also asserts that the trial court erred by adopting the wrong measure of damages. Fine cross-appeals from the trial court's refusal to award interest from the date of the fire to sixty days after the date when proof of loss was submitted.

We reverse on the ground that Fine violated the false swearing provision of the policy, thus voiding the coverage and the trial court's conclusion to the contrary cannot stand. It is therefore unnecessary for us to reach

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<sup>4</sup> The language of this policy provision is as follows:

*Concealment, fraud.* This entire policy shall be void if, whether before or after a loss, the insured has willfully concealed or misrepresented any material fact or circumstance concerning this insurance or the subject thereof, or the interest of the insured therein, or in case of any fraud or false swearing by the insured relating thereto. (App. p. A-262)

<sup>5</sup> Four months after the fire the three properties were sold in their fire-damaged condition for \$2 million with the sellers apparently retaining all rights to recovery under the policy.



the other issues raised in connection with the appeal or the cross-appeal.

### *THE FALSE SWEARING ISSUE*

The fire occurred during an extended period of extremely cold weather. Outside temperatures averaged 10° Fahrenheit on the day of the fire. Bellefonte quickly learned, as reported by the Fire Department, that the sprinkler system in the buildings had failed to operate during the fire. The rapid spread of the fire and much of the loss was attributed to the non-operation of the sprinklers.

Bellefonte also became aware, early on, of Fine's decision to rid the buildings of the existing commercial tenants and of the tenants' complaints that he had instituted a freeze-out policy. Bellefonte was naturally very interested, not only in what caused the fire, but also whether a freeze-out policy was in effect and, if so, whether Fine's actions in pursuit of the freeze-out might have contributed to the failure of the sprinkler system. An obvious theory suggested itself, i.e., that there had been extremely low temperatures in the buildings before the fire which caused the pipes in the sprinkler system to freeze and that this was the result of conduct by the insured. The facts of which Bellefonte became quickly aware suggested the possibility that further investigation might establish a material breach of the protective maintenance clause or the increased hazard clause, or both.

With this in mind, Bellefonte conducted extensive examinations under oath of Mr. Martin Fine (the one owner, among the group of owners, in charge of operating the buildings), and of Mr. George Peters, managing agent for the owners. The examination of both dealt to a

large extent with the instructions given and the provisions made for inspection and maintenance of the boiler heater and the sprinkler system, and particularly with the temperature setting employed on the heat timer that controlled the operation of the boiler.

The district court found that Fine and Peters each answered falsely during examination under oath. Both Fine and Peters stated in the examinations that they had charged the superintendent, a Mr. Aloisio, with the responsibility for inspecting and maintaining the sprinkler systems as he had been charged under the prior ownership. The trial court found such testimony to be false and that Aloisio had not been so charged or instructed.

During his examination, Mr. Fine testified that the nighttime setting for the heat timer controlling the boiler was 40 degrees and Mr. Peters testified that he had instructed superintendent Aloisio to set the heat timer at 40 degrees for nighttime operation. The trial court found that the testimony of both men was false in this respect. The court found that Aloisio had been instructed by Peters personally to set the heat timer at 25 degrees for nighttime and that Aloisio had, despite such instruction, set it for 30 degrees.

Despite the aforesaid findings of falsity, the trial court rendered judgment for Plaintiffs on the false swearing defense on the ground that the false statements were not material.

Under the heading, "Conclusions of Law", the trial court said:

"Here the statements were not material to the investigation. Given the extreme temperatures during the period from February 5th to February 14 as noted above, whether the heat timer setting was 25

degrees, 30 degrees or 40 degrees would not have affected the operation of the heating system. Further there was no testimony that a 25 degree or 30 degree setting would have constituted a practice which would have reasonably been foreseen to result in a freezing condition, which, in turn would have made the sprinkler system inoperative."

"Similarly with respect to the sprinkler maintenance issue, whether Aloisio was instructed to perform maintenance on the sprinkler system or not, in fact he did take the action necessary to repair the system, and there is no indication in this record that any failure of record keeping or regular maintenance was in any way responsible for the freeze-up. Since the Fine policy of freeze-out has not been proved to be the cause of the freeze-up, the false statements, viewing them as such, were not material as contemplated under section 168 [of New York Insurance Law]."

(App. p. A-388-89).<sup>6</sup>

The standard or test by which to measure the materiality of a statement is sometimes regarded as a pure question of law and sometimes regarded as a mixed question of law and fact. In this case, where the statements were admittedly made and the finding of their

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<sup>6</sup> Section 168(6) of the New York Insurance Law prescribes the exact language to be used in a standard fire insurance policy in New York state, including the exact language of the section on false swearing. The statutory language was followed in the instant policy. Insurance statutes in all or nearly all of the states prescribe a standard fire insurance policy including the exact language to be employed therein. R. Keeton, *Basic Text on Insurance Law* 70 (1971). Of those who do, almost all use the New York form, including its exact "False Swearing Clause". *INS. L. REP. FIRE & CASUALTY CAS. (CCH)* pp. 2002 (Dec. 6, 1972), 2003-04 (Nov. 1982), 2007-10 (Apr. 1982).

falsity is not attacked on appeal, the question seems to be purely one of law which we may consider on appeal without reference to the "clearly erroneous" requirements of Fed. R. Civ. P. 52(a).<sup>7</sup> We conclude that the standard or test of materiality adopted by the trial judge in the above quoted language was erroneous.

The trial judge regarded the materiality of the false statements as being dependent upon the ultimate determination of the facts concerning the fire as they were finally revealed to the court after a trial lasting many weeks. As the trial judge analyzed it, if it turned out, after a trial, that the sprinkler system would have been inoperative anyway on the night of the fire for reasons unrelated to the subject of the false statements, false statements about the setting of the heat timer and about maintenance and inspection of the sprinkler system made during the company's earlier investigation became immaterial. To make such statements material, the trial judge appears to reason, the insurer would have had to prove at the trial that the setting of the heat timer or a failure of maintenance of the sprinkler system caused the pipes to freeze and the sprinklers to be inoperative on the night of the fire.

In our view, the trial judge's definition of materiality was far too restrictive and not in accordance with long-established case law.

The issue is: Is a false statement material only if it relates to a matter or subject which ultimately proves to be decisive or significant in the ultimate disposition of the

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<sup>7</sup> But even if the question as posed in this case is regarded as a mixed question of law and fact, Fed. R. Civ. P. 52(a) would not preclude this Court from its own independent consideration. *United States v. United States Gypsum Co.*, 333 U.S. 364 (1948); *Karavos Compania Naviera, S.A. v. Atlantica Export Corp.*, 588 F.2d 1 (2nd Cir. 1978); *First National Bank of Cincinnati v. Pepper*, 547 F.2d 708 (2nd Cir. 1976).

claim, or is it sufficient that the false statement concerns a subject reasonably relevant to the insurance company's investigation at the time? The law is clear that the materiality of false statements during an insurance company investigation is not to be judged by what the facts later turn out to have been. The purpose of a provision requiring an insured to submit to an examination under oath is to enable the insurance company to acquire knowledge or information that may aid it in its further investigation or that may otherwise be significant to the company in determining its liability under the policy and the position it should take with respect to a claim. Thus the materiality requirement is satisfied if the false statement concerns a subject relevant and germane to the insurer's investigation as it was then proceeding.

One hundred years ago, in the seminal case of *Claflin v. Commonwealth Insurance Co.*, 110 U.S. 81 (1884), the Supreme Court stated:

The object of the provisions in the policies of insurance, requiring the assured to submit himself to an examination under oath, to be reduced to writing, was to enable the company to possess itself of *all knowledge, and all information as to other sources and means of knowledge*, in regard to the facts, material to their rights, *to enable them to decide upon their obligations, and to protect them against false claims*. And every interrogatory that was relevant and pertinent in such an examination was material, in the sense that a true answer to it was of the substance of the obligation of the assured. A false answer as to any matter of fact material to the inquiry, knowingly and willfully made, with intent to deceive the insurer, would be fraudulent. If it accom-

plished its result, it would be a fraud effected; if it failed, it would be a fraud attempted. . . . No one can be permitted to say, in respect to his own statements upon a material matter, that he did not expect to be believed; . . . *their materiality, in the eye of the law, consists in their tendency to influence the conduct of the party who has an interest in them and to whom they are addressed.*

110 U.S. at 94-95 (emphasis supplied).

As the Tenth Circuit said in a recent case: Regarding allegations of false swearing, a misrepresentation will be considered material if a reasonable insurance company, in determining its course of action, would attach importance to the fact misrepresented.

*Long v. Insurance Co. of North America*, 670 F.2d 930, 934 (10th Cir. 1982).

In *Chaachou v. American Central Insurance Co.*, 241 F.2d 889 (5th Cir. 1957), the Fifth Circuit, in dealing with a fire policy in the standard New York policy form, confronted a materiality question much like the issue before us. That court marshalled the authorities and two authorities quoted with approval in *Chaachou*<sup>8</sup> are particularly relevant.

If the plaintiffs knowingly and wilfully, with intent to defraud the defendants, swore falsely in making the proofs of loss, such act amounted to a fraud upon the defendants which avoided the policies, irrespective of the ultimate effect upon the defendants.

*Meyer v. Home Insurance Co.*, 127 Wis. 293, 299-300, 106 N.W. 1087, 1089 (1906).

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<sup>8</sup> 241 F.2d at 894 n.6.



The fatal effect, however, of a willful misstatement of fact is not disturbed because of the failure of the company to prove that prejudice was thereby occasioned. . . .

3 W. Freedman, *Richards on Insurance* § 510, at p. 1654 (5th ed. 1952).

It thus appears that materiality of false statements is not determined by whether or not the false answers deal with a subject later determined to be unimportant because the fire and loss were caused by factors other than those with which the statements dealt. False sworn answers are material if they might have affected the attitude and action of the insurer. They are equally material if they may be said to have been calculated either to discourage, mislead or deflect the company's investigation in any area that might seem to the company, at that time, a relevant or productive area to investigate.

Therefore, when measured by the proper standard and definition, each of the instant false statements was clearly material. As noted above, Bellefonte was investigating a plausible theory reasonably derived from the available facts, one which would result in the voiding of its coverage. The questions were material to that investigation. It is irrelevant whether Bellefonte was ultimately able to muster sufficient evidence to prove its theory at trial.

Bellefonte was entitled to prevail on its defense that false swearing by the insured voided the policy. The judgment of the district court is therefore REVERSED. The case is remanded to the district court with instructions to enter judgment for the defendant.



APPENDIX C

UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF NEW YORK

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MARTIN FINE, WILLIAM BECKER and PHILIP BECKER,  
individually, and WILLIAM BECKER and PHILIP BECKER d/b/a  
BECKER & BECKER, all doing business as 649 BROADWAY  
EQUITIES Co.,

*Plaintiffs,*

-against-

BELLEFONTE UNDERWRITERS INSURANCE CO., CITIBANK,  
N.A. and JOHANA ZUCKERMAN,

*Defendants.*

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80 Civ. 3747 (RWS) OPINION

APPEARANCES:

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*Of Counsel*

SWEET, D.J.

The January 3, 1984 opinion of the Court of Appeals reversed this court's judgment and remanded the case "with instructions to enter judgment for the defendant." The mandate was filed in the district court on May 7, 1984.

Plaintiffs have moved under Rule 59 and Rule 60(b)(1) and (6), Fed.R.Civ.P., to set aside the judgment and for a new trial, contending that this court should hold a new trial on the issue of the insured's wilfulness in making the false statements.

The New York law on the materiality of false swearing as declared by our Court of Appeals without reference to any current state authority is as follows:

False sworn answers are material if they might have affected the attitude and action of the insurer. They are equally material if they may be said to have been calculated either to discourage, mislead or defeat the company's investigation in any area that might seem to the company, at that time, a relevant or productive area to investigate.

*Fine v. Bellefonte*, Nos. 83-7188, 83-7198, slip. op. at 7486 (2d Cir. Jan. 3, 1984).

Plaintiffs have alleged that if the court had found the false swearing to have been "knowingly and wilfully made, with intent to deceive the insurer," such finding would have constituted a "manifest mistake of fact." There was no such finding, only a finding that the testimony given was false.

While it might be argued that a further hearing is required to determine the insurer's subjective reaction to the false testimony, even the plaintiffs wisely have not urged that such an empty exercise be undertaken. Obviously by merely posing the questions, falsely answered, the insurer determined the "area [to be one] that might seem to the company, at that time, a

relevant or productive area to investigate." *Fine*, slip op. at 7486.

As this court understands the Court of Appeals' decision, any false swearing in an examination by an insurer in a "relevant or productive area" voids the policy. No further facts need be adduced to meet this standard.

Moreover, plaintiffs' request that this court grant a new trial on the wilfulness issue is not properly before this court. Plaintiffs have twice made exactly this request to the Court of Appeals, first in a petition for rehearing and then in a petition for rehearing *en banc*. Both petitions were denied. Thus, even after having twice heard plaintiffs' arguments concerning the wilfulness issue, the Court let stand its original decision, which stated:

Bellefonte was entitled to prevail on its defense that false swearing by the insured voided the policy. The judgment of the district court is therefore REVERSED. The case is remanded to the district court with instructions to enter judgment for the defendant.

Slip op. at 7486.

"The court of appeals' rulings are the law of the case, and the district court is bound to follow them; it has no jurisdiction to review or alter them." *Eutectic Corp. v. Metco, Inc.*, 597 F.2d 32, 34 (2d Cir. 1979). The Court of Appeals has ruled, and plaintiffs have cited no material change of circumstances or newly discovered evidence so as to bring the case under the principle of *Standard Oil Co. v. United States*, 429 U.S. 17, 18 (1976).

For these reasons, the motion for a new trial is denied. The clerk is directed to enter judgment dismissing the complaint.

IT IS SO ORDERED.

DATED: New York, N.Y.  
June 15, 1984

/s/

ROBERT W. SWEET  
U.S.D.J.